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MEMORANDUM

TO: Joseph W. Ghormley, Esq. **DATE:** December 2, 2013

FROM: Hunton & Williams LLP

Enforceability of SPP Netting Practices

You asked us to assess whether Southwest Power Pool, Inc.'s ("SPP") role as the counterparty to all Integrated Marketplace[1] transactions, which excludes transmission service, ancillary services, and Market Participant bilateral/self-scheduled transactions, (hereinafter, the "Pooled Transactions") would give rise to an enforceable right of setoff for those transactions in the event that a Market Participant seeks protection under the United States Bankruptcy Code (the "Bankruptcy Code").[2] In considering this issue, we have examined the relevant provisions of SPP's Open Access Transmission Tariff ("OATT") as well as relevant state and federal law.[3]

Part I of this memorandum provides a summary of our analysis. Part II provides background information regarding this issue. Part III discusses the laws of setoff and recoupment. Part IV provides an analysis of these laws applied to SPP's tariff provisions related to Pooled Transactions. Part V indicates our view that a bankruptcy court likely would enforce SPP's netting of Pooled Transactions. Part VI limits the use of this memorandum by third parties to information purposes only.

I. EXECUTIVE SUMMARY

The Bankruptcy Code preserves for a creditor its state law right of setoff but requires the creditor to establish that the claim and debt the creditor seeks to offset are mutual. When determining whether debts are "mutual," which is not defined by the Bankruptcy Code, courts frequently examine whether: (i) the debts are between the same parties, (ii) the parties stand in the same right, and (iii) the parties act in the same capacity.

We understand that SPP has administered an Energy Imbalance Market since 2007 through which Market Participants buy and sell wholesale electricity in real-time. We also understand that on March 1, 2014, SPP plans to deploy an Integrated Marketplace, which will include a day-

[1] Capitalized terms used but not otherwise defined in this memorandum shall have the meanings given to them in SPP's OATT.

[2] The legal analysis of this issue remains the same whether a Market Participant becomes a debtor in bankruptcy under chapter 7, 9, or 11 of the Bankruptcy Code.

[3] We do not undertake to advise of any changes that might arise after the date of this memorandum.

ahead market, a real-time balancing market, and a transmission congestion rights market.[4] Upon deployment, SPP will be the counterparty to all Pooled Transactions.[5]

SPP's tariff provisions related to Pooled Transactions, which become effective March 1, 2014, establish that the payment obligations arise between SPP and each Market Participant individually.[6] In the event a Market Participant fails to perform its obligations under a Pooled Transaction, SPP has the sole right and authority under its OATT to pursue recovery of those amounts from the defaulting Market Participant.[7] In the event SPP is unable to recover on any such default, the resulting bad debt losses will be allocated *pro rata* to all Market Participants.[8]

Absent a revision to the Bankruptcy Code, it is not possible to completely foreclose an argument that SPP's ability to mutualize bad debt losses among Market Participants runs counter to a finding of mutuality in the transactions that it administers. Nevertheless, our analysis of applicable case law leads us to conclude that a bankruptcy court properly applying relevant precedent and the policies underlying the Bankruptcy Code likely would find that the requisite mutuality exists to support SPP's netting practices for Pooled Transactions because these transactions reduce to a set of bilateral payment obligations between SPP and each Market Participant. A bankruptcy court likely would consider these bilateral payment obligations the decisive factor in finding mutuality between SPP and each Market Participant to permit SPP to offset obligations owed by SPP to a bankrupt Market Participant against the obligations owed to SPP by the Market Participant. Taking title to the products bought and sold in the Integrated Marketplace further strengthens SPP's ability to enforce its netting practices in a bankruptcy proceeding because it clarifies that SPP is the counterparty and primary obligor in each of the Pooled Transactions in which it is engaged.

II. BACKGROUND

The Federal Energy Regulatory Commission ("FERC") issued Order No. 741 in October 2010 ("FERC Credit Rule"). The FERC Credit Rule prescribes new regulations applicable to ISOs/RTOs aimed at improving credit practices in organized wholesale electric markets. One of these regulations is intended to address a concern that a bankruptcy court, in the event of a Market Participant bankruptcy proceeding, might not uphold the routine netting practices of ISOs/RTOs and would decline to enforce otherwise applicable rights of setoff.

SPP's OATT, like most ISO/RTO tariffs, provides for SPP to net payments owed by SPP to a Market Participant against payments owed by the Market Participant to SPP. If a bankruptcy court did not uphold the netting practices of the ISO/RTO in a bankruptcy proceeding, then the

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[4] *See Southwest Power Pool, Inc., Submission of Tariff Revisions to Implement SPP Integrated Marketplace*, Docket No. ER12-1179-000 (filed Feb. 29, 2012); *see also Southwest Power Pool, Inc.*, 141 FERC ¶ 61,048 (2012) (order implementing SPP's Integrated Marketplace) ; *order on reh'g*, 142 FERC ¶ 61,205 (2013).

[5] *See South Southwest Power Pool, Inc., Compliance Filing to Revise Tariff Pursuant to Order No. 741*, ER13-661-000 (filed Dec. 28, 2012) ("Central Counterparty Filing") at OATT, Attachment AE §§ 3.8.1 – 3.8.3; *see also Southwest Power Pool, Inc.*, 143 FERC ¶ 61,262 (2013) ("Central Counterparty Order.")

[6] Central Counterparty Filing at OATT, Attachment AE § 3.8.1.

[7] *See* OATT, Attachment X, § 8.3 providing, in pertinent part, that SPP may "exercise any rights or remedies it may have at law or in equity, including but not limited to bringing suit or otherwise initiating proceedings for monetary damages, injunctive relief, specific performance, and relief available under the Federal Power Act."

[8] *See* OATT, Attachment L, § V.C.3.

ISO/RTO could be required to pay the full amount owed to the bankrupt Market Participant without first deducting from that amount any payments the Market Participant owed to the ISO/RTO. The ISO/RTO could then be left with an unsecured claim in the bankruptcy proceeding for the amount owed from the Market Participant that likely would be paid at substantially less than the full value.

In an effort to avoid such an outcome, the FERC Credit Rule directed each ISO/RTO to implement one of the following four options:

1. Establish a single counterparty to all market transactions by taking title to the products bought and sold in the ISO/RTO-administered market;
2. Require each Market Participant to grant the ISO/RTO a security interest in its ISO/RTO receivables;
3. Establish another method of supporting netting, approved by FERC, that provides a similar level of protection to the market; or
4. Establish credit requirements based on a Market Participant's gross obligations.

SPP complied with the FERC Credit Rule by revising its tariffs to clearly provide that effective March 1, 2014, it will take title to the products that are the subject of the Pooled Transactions that it administers.[9]

III. OVERVIEW OF THE LAWS OF SETOFF AND RECOUPMENT IN BANKRUPTCY

A. The Right of Setoff

i. Overview

The right of setoff arises under state law and allows parties that owe each other money to apply their mutual debts against each other avoiding "the absurdity of making A pay B when B owes A."[10] Generally, the right of setoff develops from debts arising from separate transactions between the same parties.[11] The Bankruptcy Code preserves for a creditor its state law right "to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case ... against a claim of such creditor against the debtor"[12] but adds additional requirements. In order for a creditor to assert a right of setoff under section 553(a) of the Bankruptcy Code, the following conditions must be met: "(1) the creditor holds a 'claim' against the debtor that arose before the commencement of the case; (2) the creditor owes a 'debt' to the debtor that also arose before the commencement of the case; (3) the claim and debt are 'mutual;' and (4) the claim and debt are each valid and enforceable."[13]

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[9] *See* Central Counterparty Order.

[10] *Citizens Bank v. Strumpf*, 516 U.S. 16, 18 (1995).

[11] *See Malinowski v. New York State DOL (In re Malinowski),* 156 F.3d 131, 133 (2nd Cir. 1998).

[12] 11 U.S.C. § 553(a).

[13] 5 *Collier on Bankruptcy* ¶ 553.03 (16th ed. 2013).

Once a creditor asserts a right of setoff under section 553(a), section 506(a) of the Bankruptcy Code provides that a claim subject to setoff "is a secured claim ... to the extent of the amount subject to setoff."[14] Thus, the preservation of a creditor's setoff rights significantly improves that creditor's position with respect to other creditors.

ii. The Requirement of Mutuality

The most frequently litigated element of Section 553(a) of the Bankruptcy Code is the requirement that the claim and debt to be offset are mutual.[15] Indeed, the FERC Credit Rule was motivated in part by concern that a bankruptcy court may not uphold ISO/RTO netting practices in the event a creditor asserts that the debts between an ISO/RTO and its Market Participant lack mutuality.

We believe that a bankruptcy court properly applying legal precedent would adhere to the language of the Bankruptcy Code and focus on whether a payment obligation exists between the parties. Taking title in the transaction provides additional support for the bankruptcy court to find that the requisite mutuality exists.

Although the Bankruptcy Code does not define the term "mutual," when determining whether debts are mutual, courts frequently examine whether: (1) the debts are between the same parties, (2) the parties stand in the same right, and (3) the parties act in the same capacity.[16] There are several categories of transactions where courts have found mutuality to be lacking. Against this background, we analyze the requirements for mutuality in the context of SPP's OATT and Integrated Marketplace structure in Part IV below.

a. Whether the Debts are Between the Same Parties

The first requirement for mutuality is that the debts are due to and from the same parties.[17] This issue often arises in the case of a triangular setoff, which, as a general rule, fails to satisfy the requirement of mutuality. A triangular setoff occurs when one party, A, attempts to set off debt owed to a second party, B, against debt owed to A by a third party, C. Mutuality is lacking because B and C are not the same parties, and A owes no direct obligation to C. In such an example, courts have refused to permit setoff because of the favorable treatment of a creditor exercising setoff rights against a debtor at the expense of other creditors, which conflicts with the general policy in bankruptcy of equal distribution to similarly situated creditors.

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[14] 11 U.S.C. § 506(a)(1).

[15] 11 U.S.C. § 553(a).

[16] *See Transit Cas. Co. v. Selective Ins. Co.*, 137 F.3d 540, 545 (8th Cir. 1998) (explaining that "[i]t is a rule of practically universal application that to warrant a set-off at law the demands must be mutual and subsisting between the same parties, due in the same capacity or right, and there must be mutuality as to the quality of right") (quoting *Sturdivant Bank v. Stoddard County*, 58 S.W. 2d 702, 704 (1933)); *In re Ronnie Dowdy, Inc.*, 314 B.R. 182, 187 (Bankr. E.D. Ark. 2004) ("In order for the debts to be mutual, they must be between the same parties standing in the same capacity."); *In re Fairfield Plantation, Inc.*, 147 B.R. 946, 952 (Bankr. E.D. Ark. 1992) (explaining that mutuality requires that "each party must own his claim in his own right severally, with the right to collect in his own name against the debtor in his own right and severally") (*quoting Braniff Airways, Inc. v. Exxon Co., U.S.A.*, 814 F.2d 1030, 1036 (5th Cir. 1987)).

[17] *Transit*, 137 F.3d at 545 (citing *Sturdivant Bank*, 58 S.W. 2d at 704).

By way of example, a recent decision from the United States Bankruptcy Court for the District of Delaware found mutuality to be lacking even though the party that owed the creditor money – C in the above example – was a subsidiary of the debtor and the parties had a contractual agreement permitting such triangular setoff.[18] The court held that under the contract, the creditor attempting to exercise setoff - A in the above example - lacked the ability to collect its debt directly from the debtor. At best, A had the right to reduce its payment to the debtor based on the amount owed to A by C. The bankruptcy court held that the debts were therefore not mutual because the payment obligation to A ran from the debtor's subsidiary, C, not the debtor.[19] To permit setoff in that circumstance would place A ahead of, and reduce available assets for distribution to, the debtor's other creditors.

b. Whether the Parties Making the Obligations Stand in the Same Right for Each Obligation

The second requirement for mutuality is that the parties to the obligations must stand in the same right for each debt. Thus, mutuality is lacking when a creditor attempts to set off an obligation that it owes to a bankrupt debtor against an obligation the bankrupt debtor owes jointly to the creditor and a third party. In this situation, the parties do not stand in the same right for each obligation. There is no mutuality because the money owed by the debtor is not owed only to the creditor but it is also owed to a different party (i.e., the third party).[20] Similar to the situation of a triangular setoff, allowing a setoff where the parties stand in different rights may harm the rights of a third party.

c. Whether the Parties Making the Obligations Act in the Same Capacity for Each Obligation

The third requirement for mutuality is that the parties to the debts must act in the same capacity for each debt. Mutuality is lacking where a party attempts to set off debt owed by it in one capacity against debt owed to it in another capacity.[21] The most common example of lack of capacity in this context arises when a debtor owes a loan to a bank and the same bank holds funds deposited by the debtor in a fiduciary capacity (e.g., as a trustee or escrow agent). When the debtor files for bankruptcy, the bank often will attempt to set off the debtor's money that it holds as a fiduciary against the money the debtor owes the bank under its loan. In this scenario, mutuality is lacking because the bank is acting in its own capacity with respect to the loan with

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[18] *See In re Semcrude, L.P.*, 399 B.R. 388 (Bankr. D. Del. 2009); *see also In re Lehman Bros., Inc.*, 458 B.R. 134 (Bankr. S.D.N.Y. 2011) (denying right of a creditor to offset debt owed Lehman Bros. against debt owed to the creditor's affiliate pursuant to a netting agreement entered into prior to the bankruptcy filing).

[19] *Semcrude,* 399 B.R. at 397. Notably, the court did not reach the issue of whether a guaranty by the debtor of its subsidiary's debt to the creditor would satisfy the requirement of mutuality.

[20] *See Gray v. Rollo*, 85 U.S. 629 (1873) (holding that Gray and Gaylord (A and B) could not offset a debt owed to an insurance company (C) against debt owed by C to Gray and his brother (A and D)).

[21] *See, e.g., Dakin v. Bayly*, 290 U.S. 143, 148 (1933) (noting that where debts are not held in the same capacity, they lack mutuality, and thus, one cannot be set off against the other); *In re Mastroeni*, 57 B.R. 191 (Bankr. S.D.N.Y. 1986) (holding that mutuality was lacking where a bank sought to setoff deposits of the debtor held in an Individual Retirement Account, with the bank as trustee pursuant to a custodian agreement, against unsecured loan payments owed to the bank by the debtor, where the bank acted as a lender, not a trustee).

the debtor – the initial obligation – but is acting in a fiduciary capacity with respect to the debtor's funds held by the bank in trust – the return obligation.[22]

B. Recoupment

Like setoff, the equitable defense of recoupment allows a creditor to offset its obligations against a debtor's claim. Unlike setoff, however, mutuality is not a statutory requirement for recoupment. Recoupment by its nature requires that the countervailing obligations arise out of a single or related set of transactions.[23] The premise underlying recoupment is that it would be inequitable to permit a debtor to enjoy the benefits of a transaction without also meeting its obligations.[24] To the extent that a Market Participant's payables and receivables arise out of the same set of transactions, a bankruptcy court may permit recoupment, without the need to analyze the "mutuality" of the obligations. Thus, while setoff involves two independently enforceable obligations, recoupment is more in the nature of a defense to the other party's claim and serves to reduce the amount of that claim.

The Bankruptcy Code does not contain a specific recoupment provision, but the doctrine has developed through court decisions, producing two distinguishable tests. The United States Courts of Appeal for the Third Circuit and the Tenth Circuit, on the one hand, have adopted the stricter of the two tests known as the "single integrated transaction" test.[25] Under this test, recoupment applies if both debts arise out of a single integrated transaction "so that it would be inequitable for the debtor to enjoy the benefits of that [single] transaction without also meeting its obligations."[26] On the other hand, the Eighth Circuit, as well as the First, Ninth, and D.C. Circuits, apply a broader test known as the "logical relationship" test. Under this test, recoupment may apply to a number of events "depending not so much upon the immediateness of their connection as upon their logical relationship."[27] While some Circuits have not officially adopted either test, we believe that a bankruptcy court would likely enforce SPP's netting of a Market Participant's purchases and sales within a particular SPP market (e.g., energy, transmission congestion rights) based on the equitable defense of recoupment under either standard.

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[22] *Mastroeni*, 57 B.R. at 191.

[23] *See Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 299 (1946) (explaining that recoupment "has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of [a] suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole"); *Terry v. Standard Ins. Co. (In re Terry)*, 687 F.3d 961, 963 (8th Cir. 2012) (noting that recoupment is only allowed if the claim to be deducted arises out of the same transaction or subject matter on which the plaintiff sued); *Fairfield Plantation*, 147 B.R. at 955 (holding that for the doctrine of recoupment to apply, there must be a single transaction between the debtor and the creditor seeking recoupment, and there must be some form of overpayment to the debtor by the creditor).

[24] *See e.g., Terry*, 687 F.3d at 963; *Conoco, Inc. v. Styler (In re Peterson Distrib., Inc.)*, 82 F.3d 956 (10th Cir. 1996).

[25] *See In re Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 973 F.2d 1065 (3d Cir. 1992).

[26] *Anes v. Dehart (In re Anes)*, 195 F.3d 177, 182 (3d Cir. 1999); *see also In re Peterson Distributing, Inc.*, 82 F.3d 956 (10th Cir. 1996).

[27] *Tullos v. Parks*, 915 F.2d 1192 (8th Cir. 1990); *Holyoke Nursing Home, Inc. v. Health Care Fin. Admin. (In re Holyoke Nursing Home, Inc.)*, 372 F.3d 1 (1st Cir. 2004); *Sims v. H.H.S. (In re TLC Hospitals, Inc.)*, 224 F.3d 1008, 1012 (9th Cir. 2000); *U.S. v. Consumer Health Services of Am., Inc.*, 108 F.3d 390 (D.C. Cir. 1997).

IV. SPP AND SETOFF AND NETTING

A. SPP Setoff and Netting Provisions

The OATT provides that SPP shall issue invoices for all charges and payments related to Pooled Transactions on a weekly basis.[28] Each day, SPP and "the Market Participant shall discharge mutual debts and payment obligations for multiple transactions due and owing to each other on the same date through netting, in which case all amounts a party owes to the other party [for Pooled Transactions] shall be replaced by a single payment obligation and netted so that only the net amount remaining due shall be paid by the owing party."[29] The net charge or credit for each day in the billing period is then listed on the weekly invoice. The sum of those daily charges or credits creates the net invoice amount. Pursuant to the OATT, SPP "shall make payments to the Market Participant for any net credit shown on the invoice and the Market Participant shall make payment to [SPP] for any net charge shown on the invoice."[30]

B. Mutuality and SPP

Under the OATT, SPP "settles, collects and distributes all charges [for Pooled Transactions]; and is the contracting party, as a principal and not as an agent, with each Market Participant for that Market Participant's [Pooled Transactions]."[31] On a weekly basis SPP will invoice Market Participants for Pooled Transactions as described above.

We believe that a bankruptcy court analyzing SPP's request to set off obligations would find the requisite mutuality exists because the transactions reduce to a set of bilateral relationships between SPP and each Market Participant, as reflected in the weekly invoices. In other words, the payment obligation or right of each Market Participant runs to or from SPP, not to or from any other Market Participant or third-party, and SPP acts as a central counterparty for those transactions.

Other factors that reflect that SPP is the primary obligor include, for example, that financial security provided by Market Participants is given in the name and for the benefit of SPP.[32] In the event a Market Participant defaults on a payment obligation, SPP is authorized by its tariffs to apply a Market Participant's collateral to reduce and/or recover its overdue payment obligation.[33] SPP also is permitted by its tariffs to pursue available remedies to recover any further amount owed.[34] Finally, when SPP pursues a judgment against a Market Participant for a bad debt, SPP brings suit in its own name and right as the counterparty to the service agreement between SPP

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[28] *See* Central Counterparty Filing at OATT, Attachment AE § 10.2.

[29] *Id.* at OATT, Attachment AE § 10.6.

[30] *Id.* at OATT, Attachment AE, § 7.2.

[31] *Id.* at OATT, Attachment AE, § 3.8.

[32] *See* OATT, Attachment X, §§ 7.1.2-7.1.3, providing, in pertinent part, "the Credit Customer shall grant to SPP a first priority security interest in and to any and all Cash Deposits, cash collateral, and deposit accounts held or controlled by SPP."

[33] *Id.* at §§ 7.1.2.3 and 7.1.2.6.

[34] *Id.* at § 8.3.

and the Market Participant. SPP is the only party with standing under the OATT to pursue a Market Participant default on Pooled Transactions.

i. SPP Netting is Limited to Debts Between the Same Parties

As discussed above, in a triangular setoff, one party, A, attempts to set off debt owed to a second party, B, against debt owed to A by a third party, C. SPP's netting practices are distinguishable from a triangular setoff because SPP, in issuing settlement invoices, only nets obligations owed directly between SPP and a specific Market Participant, and does not net obligations between SPP and any other party, including any affiliate of the Market Participant.[35] Accordingly, the obligations between SPP and any particular Market Participant are bilateral, and the corresponding setoff would not impact the rights of any third-party.

ii. The Parties Stand in the Same Right

While Market Participants ultimately share in any SPP losses, a Market Participant's obligations to SPP for its purchases are not joint obligations. In general, SPP seeks to mutualize a bad debt loss only after SPP has pursued remedies in its own name against a defaulting Market Participant.[36] Although Market Participants share in losses under the OATT, the tariff only creates bilateral obligations between SPP and each individual Market Participant.

iii. SPP Operates in the Same Capacity in Each Transaction

Courts have found that mutuality is lacking where a party attempts to set off debt owed by it in one capacity against debt owed to it in another capacity.[37] This situation is distinguishable from the relationship between SPP and its Market Participants for Pooled Transactions because SPP acts in the same capacity on both sides of those transactions. Thus, as SPP operates in the same capacity on both sides of the Pooled Transactions reflected in weekly invoices, this element of mutuality should be satisfied.

C. Setoff and Recoupment in Bankruptcy

In the event that a bankrupt Market Participant has payables and receivables with SPP, the equitable defense of recoupment likely would provide an independent basis for SPP to net those obligations. As discussed above, unlike setoff, mutuality is not a statutory requirement for recoupment. To the extent that a Market Participant's payables and receivables arise out of the

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[35] *See* Central Counterparty Filing at OATT, Attachment AE § 10.6, providing, in pertinent part, that SPP "and the Market Participant shall discharge mutual debts and payment obligations for multiple transactions due and owing **to each other**" (emphasis added).

[36] *See* OATT, Attachment L, § V.C.1-3 providing, in pertinent part, "Upon the earliest feasible date after declaring an Unpaid Obligation, SPP will take the following additional steps: (i) identify and segregate all funds held by SPP with respect to the Defaulting Market Participant; (ii) recover the Unpaid Obligation by drawing upon the entire amount of collateral provided by the Defaulting Market Participant, provided that any amount of the Unpaid Obligation not paid by such draw shall continue to be an Unpaid Obligation; (iii) seek to recover the Unpaid Obligation from any guarantor of the Defaulting Market Participant's obligations; (iv) seek to exercise other remedies under the Credit Support Documents provided by the Defaulting Market Participant; and (v) pursue other available remedies for Defaults, including, without limitation, initiating a filing with FERC to terminate the Service Agreement of the Defaulting Market Participant."

[37] *See, e.g., Mastroeni*, 57 B.R. at 191.

same set of transactions, a bankruptcy court may permit recoupment, without the need to analyze the "mutuality" of the obligations. While a bankruptcy court has not yet ruled on whether recoupment applies to transactions under an ISO/RTO tariff, bankruptcy courts have applied recoupment to a set of related transactions under a single contract in a regulated industry.[38]

If a bankruptcy court were to determine that a Market Participant's activities in different SPP-administered markets constitute separate sets of transactions such that SPP could not recoup a Market Participant's payables against its receivables across markets (for example, net payables in the Energy market with receivables in the TCR market), the court likely would still uphold SPP's right to recoupment within each market. Even under the stricter "single integrated transaction" test, a bankruptcy court would likely permit recoupment based on SPP's historic netting practice and the specific language of the tariffs that permit netting. SPP's tariffs do not permit a Market Participant to aggregate all credits within a period and demand payment without netting the credits against charges during the same period. Following this reasoning, a bankruptcy court would likely conclude that it would be inequitable for a Market Participant to enjoy the benefits of its credit transactions without meeting its obligations for its charge transactions within a single market.

V. CONCLUSION

The OATT specifies that payment obligations are between SPP and each Market Participant and payments are owed to or from SPP. Our analysis of applicable case law leads us to conclude that a bankruptcy court likely would consider these payment obligations the decisive factor in finding mutuality between SPP and its Market Participants. The provisions in SPP's OATT that provide for SPP to take title to Pooled Transactions as the market counterparty further support a finding that SPP is permitted to set off obligations owed by a bankrupt Market Participant against amounts owed to the Market Participant in accordance with its historic netting practices. Taking title in the products purchased and sold in Pooled Transactions reinforces the position that mutual obligations run from SPP to each Market Participant under SPP's tariff provisions and further demonstrates that SPP is the true counterparty and primary obligor in each of the Pooled Transactions in which it is engaged.

VI. USE OF MEMORANDUM

A copy of this memorandum may be shown to the Commodity Futures Trading Commission for information purposes only, and a complete copy of this memorandum may be posted on the CFTC's website in connection with SPP's application for an exemption pursuant to Section 4(c) of the Commodity Exchange Act, as amended.

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[38] For example, numerous courts have considered whether recoupment applies to Medicare/Medicaid "Provider Agreements" entered into by a health care provider, a fiscal intermediary, and the Department of Health and Human Services ("HHS"). The provider receives monthly advances from the fiscal intermediary based on cost estimates for various Medicare/Medicaid services provided under the provider's agreement. At the end of the year, HHS audits the provider and frequently an overpayment results. HHS then instructs the fiscal intermediary to withhold future monthly payments to recoup the overpayment. The majority of bankruptcy courts conclude that HHS may continue to recoup overpayments, even if the provider files bankruptcy. *See, e.g., Ravenwood Healthcare, Inc. v. Dept. of Health & Mental Hygiene*, Case No. MSG-06-3059, 2007 U.S. Dist. LEXIS 40796 (D. Md. 2007) (discussing line of cases). For a more detailed description of the Medicare reimbursement process, see 42 U.S.C. § 1395(g) (2006).

We note that we have found no case law directly on point. We further note that courts exercising jurisdiction under the Bankruptcy Code are courts of equity, and have the express power to issue any order or process necessary to carry out the purpose and provisions of the Bankruptcy Code. A court's decision regarding matters addressed in this memorandum will be based on its own analysis and interpretation of the factual evidence before the court and the applicable legal principles. This memorandum is not an empirical prediction as to the outcome of any future litigation, but rather provides our informed legal analysis as to the proper application of applicable law to the facts set forth herein and relied upon for purposes of this memorandum.

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Hunton & Williams LLP