

Attachment A - SC Credit Policy: Proposed Changes (Summary)

Creditworthiness

Sect.	Description	Current Policy/Procedure	Proposed Policy/Procedure	Implementation Phase
4.1	Credit Limits for SCs with ACR	SCs with an Approved Credit Limit (ACR) are given unlimited credit in the ISO's markets.	<p>The ISO would set credit limits for each SC, based on credit ratings, other third party credit assessments and entity-specific financial data. The ISO proposes specific approaches for:</p> <ul style="list-style-type: none"> • Rated Public / Private Corporations, • Unrated Public / Private Corporations, • Rated Governmentally Owned Utilities, and • Unrated Governmentally Owned Utilities. <p>Other changes include providing additional granularity in calculating credit limits, creating a \$250 million unsecured credit cap for any single entity and eliminating the use of short-term credit ratings in establishing credit limits.</p>	Phase 1
4.2	SC Identification Number (SCID)-Specific Credit Limits.	In general, the ISO does not allow SCs that use more than one SCID to schedule their transactions to segregate the financial liabilities represented by each SCID. There have been some exceptions to this rule.	The ISO will maintain its current policy without exceptions. The ISO believes that each SC represents a single financial risk, regardless of the number of SCIDs under which it schedules. Collateral posted by an SC with the ISO will secure obligations of all SCIDs scheduled by that SC.	Already Implemented
4.3	ISO-Approved Security Documents	In general, SCs use pro forma security documents for letters of credit, bill guarantees and other security documents. There have been a few	The ISO will require SCs to use standardized documents to the greatest extent possible. In special circumstances, the ISO will consider exceptions, but SCs must allow the ISO 10 business days to consider the exception. Until and unless the ISO approves an exception, SCs must use standardized documents.	Phase 1

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		have been a few exceptions.		
4.4	Security Agreement Expiration	All security documents remain in effect through their stated expiration date.	All security documents will expire and be considered void 30 days prior to their stated expiration dates. SCs can avoid a lapse in security coverage by ensuring that documents are renewed at least 30 days prior to expiration or by providing for perpetual effectiveness.	Phase 1
4.5	Credit Insurance	The ISO does not offer credit insurance, either to individual SCs or for the overall market.	The ISO will continue discussions with Aon Risk Services on various insurance proposals. It will update SCs as it finalizes the proposals.	Phase 1 (possibly) or Phase 2

Liability Obligation Calculations and Security Posting Requirements

Sect.	Description	Current Policy/Procedure	Proposed Policy/Procedure	Implementation Phase
5.1	Liability Obligation Calculations for New SCs	A new SC must post financial security for its maximum estimated financial liabilities. The ISO offers a tool for estimating liabilities, but there is no minimum posting requirement.	The ISO will continue to offer the tool, an Excel-based spreadsheet, for estimating financial obligations based on the SC's expected market activities. SCs will be required to post security to cover a minimum of two week's worth of expected market activities. The ISO will monitor each SC's liabilities weekly and request adjustments to posted security as appropriate.	Already Implemented
5.2 – 5.4	SCALE Tool	In April, 2004, the ISO implemented SCALE as the tool for estimating SCs' financial obligations.	The ISO will continue to use SCALE to estimate SCs' liabilities.	Already Implemented
5.5	Number of Days Included	Although SCs' financial liabilities vary over the	The ISO will eliminate the "Weekly Period" posting option and will require a security posting based on a level number of days	Phase 1

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	in Liability Calculation	course of a billing cycle, the ISO requires SCs to post financial security to cover their financial liabilities from the previously paid invoice to the next scheduled invoice (approximately 102 days). When PG&E and SCE began using cash deposits to provide their security, the ISO allowed them to adjust their cash postings weekly to reflect their varying liabilities.	outstanding from invoice-to-invoice. As the ISO moves to accelerated payments (planned for Q1 2006), each SC's posting requirement is expected to decrease by approximately 50 percent.	
5.6	Price Volatility and Forecasted Liabilities	The SCALE tool is based in part on market prices for energy and ancillary services, prices that, in the past, have experienced high volatility. The ISO has considered measures that could mitigate this price volatility.	SCALE uses an average of prices over the past 15 days. Recent market prices have not shown significant price spikes. The ISO believes that the potential risk reduction achieved by implementing some sort of volatility mitigation would not justify the anticipated expense or complexity.	Already Implemented
5.7	Security Postings for Special Circumstances	The ISO does not increase or decrease security posting requirements for special circumstances such as adjustments from disputes, refund orders, Good Faith Negotiations or other adjustments to	If the ISO is able to quantify an SC's financial obligations resulting from these special circumstances with a reasonable degree of certainty, it will adjust its security posting requests appropriately. It will not adjust security posting requests if it cannot do so with reasonable certainty or if the SC would not be able to post additional security significantly sooner than it could respond to the current invoice payment that includes the actual adjustments.	Phase 2

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		historical charges; SCs leaving the market; or SCs making significant changes to their business practices that affect financial obligations.		
5.8	Security Posting Requirement By Individual Trade Months	The ISO determines its security posting requests based on all un-invoiced trade months. Thus, if an SC is a net creditor in one outstanding month and a net debtor in another outstanding month, the two obligations will net against each other.	The ISO will continue this practice. The ISO settles each trade month separately, based on SCs' credits and debits during that month. Thus, there is a small possibility that there would be insufficient funds to clear the market in the case where an SC that was a net debtor defaulted on their invoice and that SC was using a different month's net credit to offset its financial obligation. However, SC payment defaults have not been a recent problem. The ISO believes the risk of additional defaults is not great enough to justify a change in this policy.	Already Implemented
5.9	Changes Resulting from New Settlement System	The ISO estimates SCs' financial obligations based on current market rules and the current settlement cycle and schedule.	As the ISO implements changes to its Settlements system, including improvements to its liability estimating tools, the Finance Department will review these impacts on SCs' outstanding financial obligations and recommend appropriate changes to its credit policies and procedures.	Phase 2
5.10	Changes Resulting From Accelerated Payments	The ISO estimates SCs' financial obligations based on current market rules and the current settlement cycle and schedule.	As the ISO implements Accelerated Payments, the Finance Department will review this impact on SCs' outstanding financial obligations and recommend appropriate changes to its credit policies and procedures.	Phase 2
5.11	Adjustments to Security Postings	Each week, the ISO estimates each SC's security posting requirements. Based on the weekly estimate, the	The ISO will base its security posting requests on the lesser of (1) the most recent SCALE figure; or (2) a moving average of the most recent SCALE estimates over the past month. This has proven to reduce volatility in security posting requests.	Already Implemented

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		the weekly estimate the ISO may request additional security or the SC may request a return of some portion of their posted security.		

Enforcement

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6.1	Unsecured Obligation Penalties	If an SC fails to provide adequate financial security, there is no financial penalty.	The ISO will continue to study how penalties might be implemented. The credit review team has considered such a penalty based on the difference between an SC's security posted and actual settlement charges. However, the ISO would not be able to implement such a penalty until the completion of the SaMC project.	Phase 2
6.2	Late Payment Penalties	There is no current penalty for SCs that fail to pay invoices by the deadline specified in the ISO Tariff.	The credit review team considered such a penalty. However, the ISO would not be able to implement such a penalty until the completion of the SaMC project.	Phase 2
6.3	SC Suspension, Disconnection and Termination	The ISO Tariff allows the ISO to suspend an SC's scheduling privileges and/or terminate an SC Agreement under certain circumstances.	The ISO is recommending changes to this policy. We invite stakeholder discussion of the current tools to address non-compliance with the collateral requirements including suspension of scheduling privileges and termination of an SC Agreement, and how they might be made more effective for all types of SCs. Any suspension/termination and disconnection process should include the following: <ul style="list-style-type: none"> • Due process - notice and opportunity to be heard prior to 	Phase 2 or later

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			adverse action; <ul style="list-style-type: none"> • The right to cure; • Notice to other affected parties, including regulatory authorities and utilities; and • Maintenance of obligations. Any suspension/termination and disconnection process should expressly provide that SC obligations under the SC Agreement remain (e.g. obligation to pay any amounts due under SC agreement and/or Tariff) even if the SC is suspended/terminated. 	

Other Issues

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7.1	Risk of Loss for Funds Held by the ISO on Behalf of Market Participants	The ISO Tariff does not currently address how to remedy the situation where funds held by the ISO as security for SCs are lost.	The ISO will propose a section to be added to the ISO Tariff that addresses the risk of loss of funds held and invested by the ISO on behalf of Market Participants. Market Participants would bear any risk of loss of principal and/or interest of such funds. The ISO investment policy will specify that it will only invest such funds in a bank account, high-quality money market fund, or US Government security unless an agreement between the ISO and SC specifies another type of investment (which would also be limited to an investment specified in the ISO Investment Policy).	Phase 1