Stakeholder Comments on

CRR Issues

Submitted by (name and phone number):	Company or entity:	Date Submitted:
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The CAISO is requesting initial written comments on the various CRR-related issues discussed at the April 1, 2008 stakeholder meeting. This template is offered as an easy guide for entities to submit comments; however, any participant should feel free to submit comments in any format. Submitted comments will be posted on the CAISO website unless participants expressly ask that their comments not be posted.

The Issues Papers and presentations discussed at the April 1 CRR Stakeholder meeting are posted at: http://www.caiso.com/1b8c/1b8cdf25138a0.html

Stakeholder comments should be submitted by close of business on Tuesday, April 8, 2008 to: CRRComments@caiso.com

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The CAISO offers the following questions as a structure for stakeholder comments:

A. CRR Year 2 Release Process

1. Does your company or entity have comments or suggestions on the historical reference period for verifying Season 1 source nominations in the next annual CRR release process?

   For simplicity, considering that the information has already been tabulated, NCPA believes that the CY 2006 historical reference period would be sufficient, but does not oppose the use of the CY 2007 historical reference period.

2. Does your company or entity have comments or suggestions on whether CRR Seasons 2 and 3 should be treated as "Year 1" or "Year 2" seasons?

   In light of NCPA's answer to question 4 below, and in consideration of the proposed modifications to CRR credit policy, NCPA believes that those CRR instruments that were

previously awarded for Seasons 2 and 3 should be retracted, and the upcoming nomination and allocation process (Year 2) should be treated as "Year 1". NCPA believes that retracting the previously allocated CRRs for Seasons 2 and 3, and treating the upcoming nomination and allocation process as "Year 1", will enable market participants to fully utilize the improvement in CRR MW Granularity, as recommended below. This treatment of Seasons 2 and 3 in the upcoming nomination and allocation process is also appropriate considering the various proposed changes to the CRR credit policy. Market participants made considered business decisions to acquire certain rights for various lengths of time based on the rules in place during the time when the initial nomination and allocation process occurred, and to the extent that those rules are modified as a result of this process, retracting CRRs previously awarded for Seasons 2 and 3 and treating Year 2 as Year 1 in the upcoming nomination and allocation process will enable market participants to reevaluate their elections based on the credit policies that are effective at that point in time.

3. Does your company or entity have any comments about the treatment of LT-CRRs?

   To the extent CRRs that were previously awarded for Seasons 2 and 3 are retracted, and the upcoming nomination and allocation process is treated as "Year 1", LT-CRRs based on those CRRs must receive similar treatment. As a result, CRRs that were previously allocated for Seasons 2 and 3, and which were converted to LT-CRRs, should be retracted and market participants should be able to convert a proportionate share of their newly acquired CRRs into LT-CRRs. This is logical because a market participant may choose to request a set of CRRs in the "revised allocation" that may or may not match its original portfolio of allocated rights. Since LT-CRRs are simply converted from a market participant's portfolio of allocated rights, it may be true that the current set of LT-CRRs may not match the results of the "revised allocation". In addition, market participants may wish to reconsider their year one choices in light of any changes to the credit and collateral requirements applied to LT-CRRs.

B. CRR MW Granularity

4. Please indicate the MW granularity that your company or entity prefers for 2009 CRRs:

   a. 0.1 MW granularity
   b. 0.01 MW granularity
   c. 0.001 MW granularity

   NCPA favors a minimum level of 0.01 MW granularity (option b) but it has no objection to adoption of a greater level of granularity, such as option c.

   If possible, please explain the business reasons for your preference.

   Moving to a minimum level of 0.01 MW granularity improves the ability of smaller Load Serving Entities ("LSE") to utilize an Existing Zone Trading Hub to manage congestion. NCPA is a smaller LSE and was directly and detrimentally impacted by the limitation

caused by the use of 0.1 MW granularity during the previous allocation process. During that allocation process, NCPA elected not to source smaller increments of CRRs that could have been used to hedge exposure to congestion associated with deliveries to smaller members sourced at a Hub, because NCPA knew its nominations would be arbitrarily reduced due to the rounding required by 0.1 MW granularity tracking limitation. As demonstrated in the CAISO whitepaper, when an LSE nominates a 15 MW CRR, moving from a 0.1 MW granularity to a 0.01 MW granularity results in a 43.5% increase in efficiency and in the amount of the request that can be awarded and tracked without significant cost. During the recent CAISO stakeholder meeting it was suggested that moving to a 0.01 MW granularity would increase the complexity associated with tracking allocated rights. However, database storage is relatively inexpensive and a majority, if not all, processing would be performed by computer based systems. Thus, NCPA believes that the efficiency gained by moving to an increased MW granularity, along with the capacity to allow hedging of smaller discrete loads, outweighs the cost associated with any potential increase in complexity.

C. 30-Day Rule on Outage Scheduling

5. Does your company or entity have comments or concerns about changing the 30-Day Rule to allow exemptions within a 24-hour period?

No Comment.

6. Does your company or entity have any further comments about exemptions to the 30-Day Rule?

No Comment.

D. Monthly CRR Eligibility for LSEs Without Verifiable Load Forecasts

7. Please indicate and explain any preference how the CAISO should determine monthly CRR eligibility for an LSE in the absence of load forecasts:

   a) Use load data from the last five relevant months
   b) Use load data from the immediate previous month
   c) Use load data from the same month of the previous year
   d) Other suggestions?

No Comment.

E. **CRR Credit Policy Enhancements**

8. What is your entity's view on the proposed options to mitigate the credit risk of CRR transfers associated with load migration as discussed in the CRR Credit Issue Paper?

No Comment.

9. What is your entity's view regarding enhancing the credit requirement calculation for holding Short-Term CRRs?

NCPA generally supports the CAISO proposal to enhance the credit requirement calculation for holding Short-Term CRRs by including a measure of expected value based on historical settlement prices. As noted in the CAISO Credit Issue Paper, there is no guarantee that the CAISO CRR auction will be robust. As a result, the prices derived from a limited auction may or may not be representative of the value of the CRRs transacted. To improve the process of calculating the expected value of a CRR, it would be more effective to base the calculation on both the results of the auction and historical settlement prices, which are derived from settlement of actual market transactions.

10. Please comment on the CAISO's intent to re-file the full-term credit coverage for LT-CRRs with the proposed modified credit requirement calculation formula.

NCPA does not believe that the CAISO has cured the original concerns that the Commission expressed with CAISO's earlier full-term credit proposal. Specifically, there is no reflection in the CAISO model of the time value of money, or of the discounting that bidders would build into their bids (when and if LT-CRRs are auctioned) in acquiring a ten-year instrument. Also, the inclusion of historical settlement prices may improve the CAISO's ability to measure the expected value of a Short-Term CRRs, but this enhancement is still not sufficient to project the value of a CRR for a full ten-year term because bidding behavior and grid topology will change over time, which will result in variable settlement pricing that will continuously change over time. As stated in the CAISO Credit Issue Paper, FERC determined that multiplying a LT-CRR credit requirement by ten (or the remaining number of years in the LT-CRRs term) the auction price of a one-year CRR does not accurately forecast the expected value of a LT-CRR for the duration of its term. Even though the inclusion of the Historical Expected Value within the short-term CRR credit requirement calculation is an improvement, it still is not sufficient to accurately forecast the expected value of a LT-CRR for the duration of its term. For example, if the auction value or the short-term historical expected value projects a negative value resulting from a limited term event in the system, this would be translated over the life of the instrument, when in fact the short term nature of the event should not reasonably be assumed to carry forward into the future. This could have significant unwarranted "virtual" impacts on an entity's credit requirement, which in turn could arbitrarily impact that entity's ability to participate in the CAISO market, even where that LSE is capable of satisfying its short term liabilities. The one-year price times ten simply is not an accurate measure, and would likely create barriers to entry for smaller entities such as NCPA while over-collateralizing the market for others.

NCPA agrees that the recent events in PJM are worrisome, but they also illustrate that the more common problem with default is likely to arise from financial speculators obtaining counterflow CRRs through the auction process rather than from LSEs seeking to hedge the congestion risks associated with serving their loads. As the Commission noted in its

recent order addressing PJM proposals to improve the collateralization requirements for the benefit of market participants, a collateral requirement that focuses on participants with net counterflow positions, which is more likely to occur in the auction process, while not affecting the credit requirements of LSEs that hedge purchases to serve load is an acceptable approach. *PJM Interconnection, LLP*, 122 FERC ¶ 61,279, P 78 (2008). While parties that take net counterflow positions provide valuable liquidity to the market, it is reasonable to ensure that those entities who willingly and knowingly undertake these higher risk portfolios have the financial wherewithal to support those positions—othewise, nothing is gained. "PJM's proposal is not intended to discourage counterflow positions, but instead to act as a safeguard that allows financially qualified participants to make available more valuable flow for other participants." *Id.* at P. 81. After all, the purpose underlying Section 217 of the Federal Power Act was to enable LSEs to hedge their loads from congestion charges. While the use of financial, rather than physical transmission rights is one way to achieve this goal, it must not overwhelm the underlying purpose of the statute, either by imposing collateral requirements so costly that smaller LSEs cannot afford to participate in the market, or by allowing defaults by speculators who then impose those costs on the market. One relatively straightforward way to achieve this goal is to match the collateral requirements to the relative risk of the market in which CRRs are acquired.

Such an approach would entail different collateral requirements for CRRs acquired through the allocation and auction process. Currently, only LSEs are eligible to participate in the allocation process (and if the CAISO decides to forbid the sale of allocated CRRs, there is little chance of non-LSEs ever having access to such rights). Unlike the auction process, where financial speculators are present, LSEs have an obligation to serve customer loads. Few of them are likely to seek out allocated net counterflow portfolios. Until such time as the CAISO makes LT-CRRs available on an auctioned basis, there would therefore seem to be little risk of long-term net counterflow positions.

An LSE's collateral requirement resulting from its portfolio of allocated rights, which in the initial allocation process were awarded based on validated sources, will, in the short term, be naturally offset by revenue received resulting from settlement of resources in the CAISO markets. Extending the collateral requirement associated with an LT-CRR by multiplying the imputed one-year price by ten years will disrupt this natural balance because revenue that results from the settlement of resources in the CAISO markets will not be considered or have been received at the time collateral requirements are determined. It is unrealistic and overly conservative to assume that these offsetting revenues will not be realized at time of settlement. This further demonstrates why the risks associated with LT-CRRs acquired by LSEs, which are primarily used to hedge congestion costs associated with serving load, are fundamentally different than those risks that may result from counterflow CRR positions taken by non-LSEs.

If there is concern that some less risk-averse LSEs would nevertheless take net counterflow positions in either allocated or auctioned rights, another option would be to increase the collateral requirements only for entities that willingly and knowingly take

such positions, whether by allocation or auction. This would entail different sets of requirements based on the risk presented by the portfolio in question, which could be akin to the approach taken in PJM.

The problem of excessive collateral requirements is more than simply theoretical for LSEs. While NCPA did not seek and did not acquire (to the best of its knowledge without actual MRTU price data) net counterflow LT-CRRs, there is always the chance that values may change. Apparently the situation in PJM resulted in part from an extended transmission outage and cooler than expected weather pattern, both eventualities that have been known to occur in California. An LSE faced with an adverse collateral call that it cannot meet (or cannot meet in five business days) due to the magnification of time (potentially ten years), which may not reasonably reflect reality and the actual risk associated with the short term nature of the anomaly, faces more serious consequences than the loss of its hedge. It also faces immediate prohibition from trading in any of the CAISO markets, a penalty that would almost certainly have adverse impacts on its ability to serve load. There must be a way to deal with these eventualities for LSEs that does not involve putting them out of business and their customers in the dark. NCPA notes that as part of this stakeholder process, CAISO has proposed credit enhancements that expressly provide for revaluing of collateral requirements in the event where these types of "extraordinary circumstance" arise. Increasing the collateral requirement associated with a LT-CRR in the simplistic manner proposed by CAISO raises the danger of limiting LSE participation in that market.

The CAISO's proposal does not indicate whether or not it intends to apply any new credit/collateral requirements to existing LT-CRRs that were already acquired in the Year One allocation process. NCPA submits that such requirements should not be imposed retroactively. NCPA and other market participants made considered business decisions to acquire LT-CRRs based on the rules in place today, and those decisions were influenced by the rules associated with collateral requirements. NCPA, which is made up of multiple conservative municipal LSEs, might well have elected not to initially participate in the LT-CRR process if the original credit/collateral proposal had been in place. LT-CRRs that have been previously awarded should not be impacted by this proposal to the extent that the credit term is extended. It is unreasonable to expose entities to obligations that they would not have been initially willing to accept by modifying the effective rules without due consideration of the very recent past. To the extent that the credit term for LT-CRRs is extended beyond a one-year term, those rights that have been previously awarded should be unaffected, and should continue to be governed by the earlier rules. Of course, if the CAISO does retract CRRs allocated for specific quarters in the first process in order to treat Year 2 as Year 1, and if LT-CRRs are also retracted, this issue does not arise.

11. What is your entity's view on whether to enhance the bidding requirement for auction participation? Should the full Credit Margin, or a portion of the Credit Margin by included in the bidding requirements? If a portion of the Credit Margin is preferred, what is your entity's suggestion on the appropriate percentage?

NCPA generally supports the CAISO proposal to enhance the Pre-Auction Credit Margin Requirement which would require participants in the auction process to demonstrate sufficient collateral prior to taking ownership of auctioned rights. The underlying purpose of developing CRR instruments is to provide LSEs a financial hedge against congestion costs. NCPA believes that this requirement should be unique to the CRR auction because unlike the CRR allocation process, which is only available to LSEs that in general are selecting CRR instruments to hedge congestion costs associated with their existing power supply portfolios, the auction is more speculative in nature and will tend to encompass activity based on arbitrage.

12. Please comment on the proposed Tariff clarification to increase credit requirements for CRRs due to extraordinary circumstances such as extended outage or other circumstances that could dramatically change the risk profile of a CRR.

    The concept in general appears to be reasonable, but NCPA is unable to fully support such a concept at this time because the proposed language, as stated in the CAISO Credit Issues Paper, is very general. Such an event is variable in nature, but the process for increasing credit requirements due to "random" events must be calculated based on a structured process to allow market participants to validate the risk of such an event. The current description encompassed within the CAISO Credit Issue Paper must be expanded to include a predefined process for calculating such exposure.

13. Does your company or entity have comments on the concept for requiring corporate parent credit backing of affiliated market participants' Estimated Aggregated Liability? Is there merit in this potential change? Should this concept apply to other forms of collateral, or just guarantees? Would this concept present regulatory difficulties for affected entities?

    No comment at this point in time.

F. Other CRR Issues

14. Does your company or entity have further comments or suggestions on these various CRR issues?

    No additional comments at this time.