



CALPINE Corporation
Western Region
4160 DUBLIN BOULEVARD
DUBLIN, CA 94568
PHONE: (925) 479-6600
FAX: (925) 479-7309

CALPINE'S COMMENTS ON THE CAISO'S PAYMENT ACCELERATION PROJECT WHITEPAPER

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Calpine Energy Services, L.P., and Calpine Corporation (jointly Calpine), appreciate this opportunity to comment on the California Independent System Operator Corporation's (CAISO) Payment Acceleration Project Whitepaper dated October 25th, 2004, (Whitepaper) and the CAISO's Scheduling Coordinator Credit Policy Review, dated November 10, 2004 (Credit Policy Review). Calpine heartily endorses the CAISO's efforts to reduce credit risk, including enhancing market access and participation through accelerated settlements.

As discussed further below, Calpine further encourages the CAISO to: (i) to assess the feasibility of moving to weekly billing given recent developments in other ISOs and at the Federal Energy Regulatory Commission (FERC); (ii) explore the feasibility of market clearing; (iii) update its benchmark study to reflect recent improvements in settlements and billing by peer ISOs/RTOs; and (iv) expand stakeholder participation in the development of an accelerated payment calendar, as well as other improvements in the CAISO's credit policies.

Settlement and Billing Cycle Reduction

In the Whitepaper Executive Summary, the CAISO states that (a) the CAISO payment calendar currently poses undue credit risk to market participation based on the amount of time from trade date to market clearing, and (b) that this increased risk hinders resource availability from out-of-state resources, complicates credit management, and exposes market participation to unacceptable risk in the event of defaults and bankruptcies. To reduce this "undue" credit risk as well as other settlement improvements, the CAISO has proposed market clearing 20 days after the end of the trade month, with an implementation date sometime in early 2006.¹

Presently the CAISO current payment calendar defers initial settlement of market charges for up to 90 days², and as the CAISO notes in its Whitepaper, this is longer than any other energy market, and poses unnecessary risks of defaults or bankruptcies. Moreover, the CAISO states that payment acceleration would significantly reduce required security requirements, as the current method of calculating of credit assurance requires that the Scheduling Coordinator (SC) post three months worth of credit with the CAISO in order to participate in CAISO administered markets.³

¹ Whitepaper, pg. 3. CAISO also identified other potentially significant settlement improvements including more flexibility with the dispute window and implementing sunset provisions for settlement changes.

² Per the CAISO 2004 Payment Calendar, GMC and Market Preliminary invoice due by 10 AM T + 43 Business Days from the end of the month of the trade month.

³ Whitepaper, pg.4.

While Calpine appreciates CAISO's recognition of the credit risks and impact on market participation on CAISO administered markets imposed by CAISOs present settlement cycle, Calpine strongly believes that CAISO should use this opportunity to assess the feasibility of moving to weekly billing, as other ISOs have successfully implemented, or are in the process of implementing.

Weekly billing has shown to provide significant reductions in loss mutualization within ISO markets, and similarly significant reductions in collateral required by market participants to participate in those markets. In the case of NEPOOL, ISO-NE data indicates that there is a significant impact on collateral requirements from shortened settlement cycles, where "ISO-NE project[ed] that the overall amount of financial assurance required in the Pool would be reduced from approximately \$176,791,000 currently to \$58,128,000"⁴. While a projected reduction of over \$118 million in collateral requirements is a significant improvement to market efficiency by itself, this projected reduction illustrates the even greater magnitude of reduced risk of a default to all market participants. Since the implementation of weekly billing, ISO-NE staff has confirmed that weekly billing has reduced NEPOOL exposure from market participants by approximately 65%.⁵

In the instance of NEPOOL, the estimated reduction of collateral of \$118 million was based on moving from a settlement cycle that was approximately 55 days (mid-month following the month of delivery). The CAISO only proposes shortening its initial settlement cycle from its current 85-90 days to the mid-month following delivery. Clearly, based on the NEPOOL experience, further substantial reductions in the risk of loss mutualization and collateral from the 50-ish days CAISO proposes, are not only possible, but have been realized by NEPOOL to the benefit of all its markets stakeholder.

Not only has FERC accepted and NEPOOL successfully adopted weekly billing, but MISO also recently filed with FERC its "Day 2" Tariff, which has been conditionally accepted, and which also provides for weekly billing. Calpine further understands that SPP is currently working with its stakeholders to develop a weekly billing settlement cycle, and that these efforts are ongoing. Moreover both PJM and NYISO are subject to FERC Orders to explore through its stakeholder process if additional changes can be made to the settlement or credit procedures including accelerated billing⁶.

In addition, a very recent development in the area of accelerated settlements is the FERC Policy Statement on Credit Related Issues dated November 19, 2004. While the Policy Statement addresses many different credit related areas of ISO/RTO administered markets, FERC has stated through this Policy Statement that it supports accelerated settlements, including weekly settlement, and explicitly references the expected benefits of weekly billing.⁷ The Policy Statement requests that ISO/RTOs report back within 90 days their progress in implementing among other things shortened settlement periods.

⁴ Memorandum to NEPOOL Participants Committee re: Amendments to Billing Policy and Financial Assurance Policies to Implement Weekly Billing, Paul Belval and Scott Myers, NEPOOL Counsel, February 12th, 2004

⁵ ISO-NE staff update to the NEPOOL Budget and Finance Committee on the impact of weekly billing on NEPOOL administered markets

⁶ 104 FERC ¶ 61,311 (Sept. 22, 2003) -NYISO and 104 FERC ¶ 61,309 (Sept. 22, 2003) -PJM. Both PJM and NYISO have made status filings, and continue to work with their stakeholders on these issues.

⁷ 109 FERC ¶ 61,186 (November 19, 2004)

Market Clearing

Calpine would also suggest that CAISO explore the feasibility of market clearing, as Calpine is aware that there are several clearing solutions proposed for the ISO/RTO marketplace today, and other ISO/RTOs have had varying degrees of review of the feasibility of market clearing in their market. In fact, in ERCOT administered markets, ERCOT has issued an RFP to have a 3rd party administer (clear and settle) its planned Day Ahead Market in 2005.⁸

Updating Benchmark Study

As well as the Whitepaper on accelerated settlements, CAISO has prepared the Credit Policy Review, which addresses many other areas of the Credit Policy that CAISO wishes to review. CAISO management tasked the Credit Policy Review Team with achieving the goals of (i) confirming/revising CAISO standards for SC financial security to minimize credit risk, and enhance confidence in the CAISO markets and (ii) establish fair and transparent mechanisms to enforce credit standards to maintain CAISO market's financial integrity.

CAISO notes in its Credit Policy Review that to meet the objectives set by management that the Team (i) reviewed other ISO/RTOs credit policies, (ii) identified aspects of the CAISO credit policy that could be improved, (iii) developed recommended changes to the Policy, and (iv) identified issues where further consideration of potential solutions with stakeholders is necessary.

Calpine appreciates that CAISO determined that a benchmarking of its Credit Policy against those of its peers at other ISO/RTOs is a prudent first step in evaluating the CAISO Credit Policy, however, this benchmarking was completed in November 2003. Further, CAISO states that in many instances, the provisions of other ISOs' credit policies substantially guided the recommended changes contained in this document".

Since November 2003, the Tariffs/Protocols of the ISO/RTOs CAISO has benchmarked itself against have seen substantial changes, dramatically impacting credit standards, including settlement cycles, credit scoring, netting and set-off, and suspension rules. Additionally, since November 2003, there have been various regulatory proceedings and market design issues having a material impact on credit standards in the ISO/RTO markets (for example both PJM and NYISO have filed compliance reports to FERC on the status of their 180 day compliance orders).

Just a few examples of some of the changes that have transpired with the ISO/RTOs CAISO benchmarked itself against since November 2003 include:

- ERCOT stakeholders voted to issue an RFP for a 3rd party to administer (clear and settle) its planned Day Ahead Market ("DAM") in 2005;
- NEPOOL adopted weekly billing;
- MISO has received conditional acceptance of its Day 2 Tariff, including a provision for weekly billing; and
- FERC has issued the recently released November 19th, 2004 Policy Statement on Credit Standards.

⁸ ERCOT Board of Directors, on the endorsement of the Technical Advisory Committee, and as approved by the stakeholders at the Wholesale Markets Subcommittee (July 17, 2004), approved ERCOT issuing a RFP on July 28, 2004 requesting a 3rd party to provide proposals to clear and settle the Day Ahead Market, as mandated by PUCT Rule 25.501 (either ERCOT or contracted).

In light of the significant material developments since CAISO completed its benchmarking, especially the recently released FERC Policy Statement, it would be prudent for CAISO to use this opportunity to reopen its benchmarking study and reassess what parts of the current CAISO credit policy can be improved and develop specific recommendations.

Stakeholder Participation

Calpine emphasizes the importance of developing these recommendations/ solutions through active stakeholder involvement. Active involvement by all stakeholders in this process will bring to CAISO input from stakeholders who are active in other ISO/RTOs, bring diverse viewpoints from different stakeholders/market segments to potential issues, and bring expertise from the world of credit risk management, all in a fair and transparent process. Such a stakeholder driven process could provide other possible opportunities to achieve CAISO's stated goals and objectives.

Calpine would further recommend that this stakeholder process for this review be expanded to be a formal group, to deal with credit related issues. Setting-up a standing group, who meets regularly to aid CAISO and its stakeholders in credit related matters would be consistent with every other ISO/RTO in the US (i.e. ERCOT –Credit Working Group, NEPOOL –Budget and Finance Sub-committee). Additionally, for further transparency and for good governance, Calpine would recommend that the CAISO stakeholders elect stakeholders to the leadership positions (Chair, Vice-chair), which again is consistent with the majority of the other ISO/RTOs.

Conclusion

Calpine thanks the CAISO for this opportunity to provide comments and looks forward to further participation in this stakeholder process. If you have any further questions, please do not hesitate to contact Morgan Davies, Credit Manager, at DaviesM@calpine.com or Linda Y. Sherif, Regulatory Counsel, at Lsherif@calpine.com. Calpine is committed to working with CAISO and other stakeholders in improving the CAISO settlements process.