

Stakeholder Comments Template

Subject: Credit Policy Enhancements Straw Proposal

Submitted by	Company	Date Submitted
<i>Please fill in name and contact number of specific person who can respond to any questions on these comments.</i> <i>Jerry Green (916) 574-1296</i>	<i>Please fill in here</i> <i>California Department of Water Resources – State Water Project</i>	<i>Please fill in here</i> <i>November 4, 2008</i>

This template has been created for submission of stakeholder comments on the topics covered in the October 27, 2008 Credit Policy Enhancements stakeholder call. Upon completion of this template, please email your comments (as an attachment in MS Word format) to CreditPolicyComments@caiso.com. All comments will be posted to CAISO's Credit Policy Stakeholder Process webpage at <http://www.caiso.com/docs/2003/04/21/2003042117001924814.html>.

Submissions are requested by close of business on **November 4, 2008 or sooner**.

Please submit your comments to the following questions for each topic in the spaces indicated.

1. Are you generally in favor of the ISO establishing credit policies, such as the three enhancements presented during this stakeholder process, that result in more conservative unsecured credit limits?

Response: Yes.

CAISO Response: Noted.

2. Do you support the ISO's straw proposal to use the lowest Credit Agency Issuer Rating when two or more issuer ratings are available? If only a short term rating is available, do you support the use of the lowest equivalent long term rating?

Response: Yes.

CAISO Response: Noted.

3. Do you agree with the concept that having a large portion of Total Assets comprised of assets that are generally unavailable to settle a claim such as restricted assets, affiliate assets and derivative assets (i.e., using the net of these asset categories if an offsetting liability is reported) should result in a lower or even no Unsecured Credit Limit? If you agree, should the ISO specifically exclude these types of assets in the definition of Tangible Net Worth as originally presented or consider them as part of the qualitative assessment in step 8 of the eight-step process as presented in the straw proposal?

Response: We agree that the CAISO should have the ability to lower UCL's based on certain types of assets but should consider the assets under review as part of the qualitative assessment exercise.

CAISO Response: Noted. As it turns out, there are challenges with lowering UCL solely on the qualitative assessment of certain assets – particularly applying this subjective analysis in a consistent manner. The final solution may require a combination of both exclusion and qualitative assessment. Exclusion, if applied by ensuring matching assets and liabilities are included in the calculation, removes the subjectivity of a qualitative assessment alone. However, because certain of these items (e.g. derivative assets and liabilities) can swing wildly from one reporting period to another – sometimes making the difference of getting unsecured credit during one reporting period or not – CAISO needs to retain the flexibility to use the qualitative assessment to reduce unsecured credit based on the uncertainty of these assets contribution to Tangible Net Worth from one reporting period to the next.

4. Do you support the ISO's straw proposal to reduce the current maximum amount of unsecured credit to \$150 million on the condition that the ISO reassess this amount with the release of Payment Acceleration and after MRTU has been successfully running through the summer months of next year?

Response: Yes.

CAISO Response: Noted.

5. Do you support the ISO's straw proposal to accept non-U.S. and non-Canadian guarantees if the ISO adopts strict criteria similar to PJM and MISO? In addition, do you support the straw proposal to adopt MISO's maximum unsecured credit limits based on a minimum country rating and the guarantor's credit quality?

Response: Yes to both.

CAISO Response: Noted.

6. Do you support the ISO's continued development of the Affiliate Guaranty? What are your legal department's concerns, if any, with the ISO's form Affiliate Guaranty?

Response: We are in support of the ISO's continued development of the Affiliate Guaranty. Our legal department is unable to comment or provide concerns at this time.

CAISO Response: Noted.

7. With the knowledge that the ISO already has response time built into a collateral request, do you support the ISO's straw proposal to reduce the time to post additional Financial Security to three (3) Business Days?

Response: Consistent with our comments submitted in the first round (comments dated October 3, 2008) we have concerns that for some counterparties shortening the cure period may not result in the desired outcome of attempting to limit the Market Participants to defaults. Some of us are Market Participants not by choice but because our charter necessitates that we are and the fact is we provide an essential commodity and service to the California economy. We could find ourselves in a situation where a three day cure period isn't a sufficient time to secure approval for an increase in an existing letter of credit or to secure a new letter of credit and contrary to comments from some Market Participants in the first round can't simply bridge the gap by providing cash because of contractual stipulations with our constituents. We urge the CAISO to consider that not all Market Participants are the same (not all participate in the market as profit maximizing firms, some participants must use the CAISO market as a means to provide their chartered services and strive to do so with a cost minimization goal in mind) and that a one size fits all policy may not be advantageous to all Market Participants collectively. As stated previously we aren't quite sure how the CAISO fairly handles the different situations but think it prudent for the CAISO to consider the different classes of Market Participants and use some judgment when assessing a particular situation that results in a collateral request and an entity's efforts to comply with the request.

CAISO Response: CDWR raises valid concerns about the ability of certain entities to respond quickly to collateral requests due to internal considerations, but is hopeful that such barriers can be overcome. CAISO recognized these issues in declining to reduce the response period to two days as suggested by some Market Participants during this stakeholder process. The same concerns that CDWR raises for a three day response period may exist today with the current five day posting requirement. To avoid frequent collateral calls, some Market Participants choose to maintain a higher level of collateral to avoid these calls or make prepayments against an upcoming invoice. Inasmuch as the other ISOs/RTOs and the majority of CAISO Market Participants (who understandably operate differently than CDWR) supported CAISO's straw proposal or an even shorter posting period (as short as one day), it is likely that CAISO will proceed to implement this proposal. However, CAISO will further discuss these issues with CDWR, as necessary. Further exploration of this issue may also be an appropriate topic for Credit Working Group consideration.

8. Do you support the ISO's straw proposal to limit the amount of collateral for a CRR auction to 90% of available credit? Do you agree that Candidate CRR Holders that do not otherwise participate in the ISO market should be excluded from this policy?

Response: Yes to both.

CAISO Response: Noted.

9. Upon finalization of all post MRTU design and implementation details of the financial penalties enhancement for late payers, do you support the ISO's straw proposal to assess Market Participants a financial penalty of an amount not to exceed \$20,000 calculated as the greater of 2% of the invoiced amount but not less than \$1,000 when a Market Participant pays an invoice late two or more times within a rolling twelve month period? Secondly, do you support the straw proposal that reduces a Market Participant's Unsecured Credit Limit to zero and require cash collateral for those Market Participants who pay late a third time within a rolling twelve month period? Thirdly, do you support funding a market reserve account with these financial penalties to a limit of \$5,000,000 with any funds in excess of this amount used as a credit toward the GMC revenue requirement in the subsequent year? Lastly, do you support the immediate implementation of the progressive discipline program, as outlined in the straw proposal document?

Response: Yes, to the financial penalty not to exceed \$20,000 for late payment on an invoice when paid late two or more times within a rolling twelve month period.

No, with a very strong conviction to the straw proposal that reduces a Market Participants unsecured credit limit to zero and requires cash collateral for those Market Participants who pay late a third time with a rolling twelve month period. This proposal may make sense as an overall safety measure for those Market Participants that choose to participate in the CAISO market but I suspect that for those Market Participants that have to be in the CAISO market (such as public utilities and governmental entities) eliminating their unsecured credit limit and requiring a cash posting could be disastrous and overly burdensome to their ability to meet their mandates.

Yes, we are in support of funding a market reserve account with these financial penalties to a limit of \$5,000,000. We are also in support of either the CAISO or the Credit Working Group investigating if capping the reserve account at \$5,000,000 is optimal or if some other amount for the reserve account makes more sense. We are in favor of distributing penalties collected that exceed the optimal reserve account balance via the GMC revenue requirement in the subsequent year.

Lastly with respect to immediate implementation of the progressive discipline program outlined in the straw proposal document consistent with our comments above on the proposal to revoke a Market Participants unsecured credit limit we are not in favor of this aspect for those Market Participants that must be in the CAISO markets in order to meet their chartered purpose for being (i.e., public utilities and governmental entities).

CAISO Response: Noted. Market Participants who are consistently late in paying their invoices pose a significant risk to the CAISO market of either a delay in paying the market or a short payment to net creditors as the result of a payment default. When a Market Participant is late in paying their invoice, the CAISO must look to any form of Financial Security it has to draw on to cover the invoice in order to pay the market. For a Market Participant to pay late three or more times in a rolling twelve month period is a serious problem requiring harsher penalties. CAISO appreciates CDWR's concerns about the potential impact of this policy on certain types of entities, and is willing to further explore this issue in the Credit Working Group, but believes that the proposal should proceed at this point for implementation, with revisions possible later.

10. Upon finalization of all post MRTU design and implementation details of the financial penalties enhancement for not posting Financial Security within the posting period, do you support the ISO's straw proposal to assess Market Participants a financial penalty of an amount not to exceed \$20,000 calculated as the greater of 2% of the invoiced amount but not less than \$1,000 when a Market Participant fails to post Financial Security within the prescribed posting period on the third and each subsequent occurrence within a rolling twelve month period? In addition, do you support funding a market reserve account with these financial penalties to a limit of \$5,000,000 with any funds in excess of this amount used as a credit toward the GMC revenue requirement in the subsequent year? Lastly, do you support the immediate implementation of the progressive discipline program similar to the one described for late payers for failing to post on time?

Response: Comments (and rationale) similar to those submitted under question 9 above and to some extent question 7 above.

CAISO Response: Noted.

11. Considering the Credit Working Group (CWG) structure and governance limitations described in the straw proposal, how would you see the CWG complementing the ISO's existing stakeholder process? Besides Market Participant credit and risk management professionals, who outside the ISO would add value and bring expertise to the CWG?

(Submit Comments Here)

12. Please provide detailed pros and cons as well as consequences of the ISO continuing with its existing loss sharing policy. Are there certain credit policy enhancements that more equitably result in Market Participants sharing the risk of participating in the ISO market?

Response: While not being able to provide detailed pros and cons at this time will reiterate comment on this subject provided in the first round of comments which was that we are in favor of modifying the current methodology for socializing defaults to one that

matches other ISO's/RTO's and doesn't put the entire burden on net creditors of the market for the month in which the payment default took place.

CAISO Response: Noted. CAISO is committed to exploring loss sharing and other credit policy enhancements that would better equalize the risk among all Market Participants participating in the CAISO market. Due to widely disparate views on this issue as well as CAISO resource and system constraints as previously described during the course of this stakeholder process, the CAISO will continue discussion of this topic outside of the current credit policy enhancement stakeholder process.

13. Are you in agreement with the ISO's decision to remove the market funded reserve account and credit insurance from further consideration during this stakeholder process?

Response: Yes.

CAISO Response: Noted.