Stakeholder Comments Template

Subject: Credit Policy Enhancements Straw Proposal

Submitted by	Company	Date Submitted
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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?

   We are generally in favor of the three enhancements described in Sections 3.1, 3.2and 3.3 of the October 20th Straw Proposal which modify how the unsecured credit limit is established.

   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?

   We support the use of the lowest Credit Agency Issuer Rating.

   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?

   We agree, however each asset must be evaluated individually to avoid double exclusion. In some instances, an entity's balance sheet already reflects an off-setting liability for a reserved or earmarked asset account. Examples include decommissioning funds or funded debt reserves. When the entity's balance sheet reflects a liability that offsets an earmarked or reserved asset, then subtracting that asset from Tangible Net Worth effectively would double count the exclusion.

   CAISO Response: The CAISO recognizes this concern and will develop a final proposal that offsets any reserved or earmarked asset account with its matching liability to avoid the double counting issue that you describe.

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?

   We support lowering the unsecured credit limit.

   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?

   We support the proposal to allow the CAISO to accept non-U.S guarantees under strict criteria, but request further discussion on how the maximum unsecured credit limit would be established.

   CAISO Response: CAISO recognizes that it cannot eliminate all the risk of accepting a foreign guaranty. Therefore, it doesn't believe, at this time, that a foreign entity should receive the same level of unsecured credit as a domestic entity. The MISO approach provides increasing levels of unsecured credit to a predefined maximum that is lower than the amount they would provide a U.S.-based entity. The unsecured credit limit is only provided to the most creditworthy companies on a graduated scale based on credit rating. CAISO believes this is a workable model

but remains open to stakeholder input related to implementation detail. CAISO encourages you to contact credit staff to discuss any further concerns.

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?

   Yes, we support the continued development of this tool.

   <u>CAISO Response</u>: 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?

   Yes.

   <u>CAISO Response</u>: Noted.

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?

   Yes, we support the proposal to limit the amount of collateral for a CRR auction to 90% of available credit. Our position is that all participants who pose a credit risk to the CAISO should participate in this policy, so to the extent that a CRR holder poses a credit risk, they should not be excluded. We suggest that the details of participation be developed by the Credit Working Group.

   <u>CAISO Response</u>: Noted. With respect to the suggestion to limit the application of this rule to only entities that pose a credit risk, this topic may require additional discussion. The proposal would apply to any entity other than those solely bidding in a CRR auction. The rationale for that is that some entities may only participate in the CRR auction and have no other market activity. If they post, for example, the minimum of $500,000 to participate in the auction, it didn't seem appropriate to limit that amount to $450,000 (90% of $500,000). The first problem is that this policy would result is this entity immediately violating the minimum collateral requirement to participate in the auction. One of the purposes of this policy change was to ensure that Market Participants retained enough collateral to 1) not immediately trigger a collateral call and 2) leave a sufficient cushion for other market activity. This policy does not affect any CRR credit holding requirements that may result from the auction.

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?

It is unclear why a cap of $20,000 was selected. The penalty should serve as a disincentive to all participants from paying late. More discussion may be necessary to determine if the amount of the cap truly serves as a penalty to all participants.

We suggest that the Credit Working Group consider some type of a review, or additional steps, prior to reducing a participant's unsecured limit to zero after two late payments. A suggestion might be a percentage reduction of the unsecured credit limit and the payment of the penalties daily, as well as the payment of interest. We understand that late payments cause delays in payment of the CAISO's debits, however a late payment of $100 may not warrant the measures outlined, whereas a 3 day late payment of $2,000,000 may warrant more than a $20,000 penalty.

The funding of the market reserve account from penalties, as outlined in the proposal, versus refunding the penalty to the market in the form of lowering GMC's might best be saved as an item for discussion by a credit working group. If the credit risk stays only with net creditors, then we would support the funding of the reserve account as proposed.

Yes, we support the immediate implementation of a progressive discipline program as modified in our response.

<u>CAISO Response</u>: Comments related to the progressive discipline program are noted.

The purpose in setting a cap was to provide a reasonable incentive to make on-time payments yet avoid unreasonably high and burdensome penalties that might induce unintended consequences such as a payment default.
CAISO agrees that implementation details around theproposal can continue to be reviewed but also believes it is a reasonable starting point to get this policy off the ground.

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?

Yes. See comments in Number 9 above.

<u>**CAISO Response**</u>**: 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?

The CWG would be a valuable forum to identify and address credit issues and potential revisions to the CAISO's credit policy in a timely manner, prior to introducing them to the Board. If the CWG determines that particular outside professional expertise is warranted, a funding mechanism should exist to provide this assistance that would ultimately benefit all market participants.

<u>**CAISO Response**</u>**: Noted. CAISO will consider stakeholder comments on this matter and work to arrange a CWG for future credit policy enhancements.**

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?

All market participants should share in the risk of default. If this is not the case, then incentives are created for participants to manipulate their portfolios to avoid this risk. The current mechanism provides an incentive for participants to ensure they are net debtors at the end of the month. If all participants shared the risk based on "net monthly position", this would also provide an incentive to manipulate their portfolios (e.g., structuring transactions such that net monthly activity is close to zero and thus avoid "sharing the risk"). This is an issue that would be ideal for a Credit Working Group to determine a fair allocation to all market participants that is not unfairly more burdensome on one set of participants over another.

This should be their first priority and should be implemented as soon as possible.

<u>**CAISO Response**</u>**: Noted. CAISO is committed to exploring loss sharing and other credit policy enhancements that could result in a fairer allocation of default risks 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?

    At this time, yes. The potential costs appear to outweigh the benefits outlined.

    CAISO Response: Noted.