Comments of J.P. Morgan Ventures Energy Corporation
Subject: CAISO Final Credit Policy Enhancements Proposal

Submitted by	Company	Date Submitted
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<u>General Comments</u>

J.P. Morgan Ventures Energy Corporation (J.P. Morgan) appreciates this opportunity to submit comments to the California ISO (CAISO) on the CAISO's Final Proposal on its proposed enhancements to its established credit policies. As previously indicated, J.P. Morgan strongly supports the CAISO's proposal to strengthen its credit policies and align its policies with the "best practices" in place in both other organized electricity markets as well as other financial markets. In addition, J.P. Morgan continues to believe that the best means to reduce market risk is to finalize and implement the CAISO's Payment Acceleration proposal, thus significantly reducing the amount of required credit in the CAISO's market. As stated in its comments to the CAISO on the CAISO's Payment Acceleration initiative, J.P. Morgan supports expedited implementation of the CAISO's Payment Acceleration proposal.

J.P. Morgan generally supports most of the CAISO's proposed changes to its credit policies. J.P. Morgan believes that most elements of the proposal will bring the CAISO's policies in line with those in place in other organized electricity markets and are appropriate and responsible refinements to its existing policies. However, J.P. Morgan remains concerned with two aspects of the proposal.

First, J.P. Morgan recommends that the CAISO eliminate the use of unsecured credit. No financial market permits the use of unsecured credit; all participants must be fully collateralized. In addition, the exigent circumstances in the financial markets warrant reexamination of this issue in all organized electricity markets. As California is aware, high credit ratings and presumed regulatory backstops are insufficient to prevent defaults in electricity markets and, at present, the consequences of such defaults are allocated to only a subset of market participants.

Second, J.P. Morgan does not support the CAISO's proposal to defer addressing the default allocation methodology. While J.P. Morgan believes the existing default allocation methodology is unjust and unreasonable on its face, continuation of the existing default loss allocation methodology is especially egregious if the CAISO continues to permit use of unsecured credit (even if at a reduced maximum threshold). J.P. Morgan recommends that the CAISO modify the default allocation methodology to allocate the cost of defaults of any unsecured creditor to either those market participants that voluntarily rely on unsecured credit or, consistent with the practices in place in other organized electricity markets, allocate such costs to all market participants based on gross billings in the market. Additionally, the cost of any other defaults should be allocated to all market participants based on gross billings.

In conclusion, J.P. Morgan supports the majority of the CAISO's recommended enhancements to its credit policy but recommends that the CAISO 1) eliminate the use of unsecured credit in its markets; and 2) change the default cost allocation methodology to allocate such costs to those that rely on unsecured credit or to all market participants based on their gross billings in the market.

Calculation of Unsecured Credit

J.P. Morgan supports the elimination of unsecured credit. That fact notwithstanding, J.P. Morgan generally agrees with the CAISO's proposal to calculate unsecured credit using the lowest Credit Agency Issuer Rating when two or more issuer ratings are available and the use of the lowest equivalent long term rating if only a short term rating is available. J.P Morgan also supports the blending of Moody's KMV equivalent rating and lowest credit agency issuer rating and to replace the default probability table in the CAISO Tariff with fixed percent of Tangible Net Worth or Net Assets based on rating. J.P. Morgan believes that the CAISO's revised approach will result in better leading indicators regarding an entity's financial status.

Definition of Tangible Net Worth

As previously stated, J.P. Morgan agrees that market participants that have a large portion of their total assets comprised of restricted assets, affiliate assets and derivative assets should have a lower or no Unsecured Credit Limit. J.P. Morgan supports the specific exclusion, in the definition, of certain assets (e.g., restricted assets, affiliate assets, derivative assets, and other assets reasonably believed to be unavailable to settle a claim in case of default) net of any matching liabilities. As previously stated by J.P. Morgan, J.P. Morgan understands that it may not be possible to include by name all such possible restricted assets in the definition of Tangible Net Worth. Therefore, J.P. Morgan supports the CAISO's proposal to retain and exercise appropriate discretion in excluding other restricted assets when determining an entity's Unsecured Credit Limit.

Unsecured Credit Limit

As stated above, J.P. Morgan supports the elimination of unsecured credit. However, J.P. Morgan prefers the CAISO's final proposal to reduce the current maximum amount of unsecured credit to $150 million over maintaining the present tariff provisions and the $250 million limit. While J.P. Morgan initially supported the CAISO's original proposal to reduce the Unsecured Credit Limit to $100 M (from $250 M), J.P. Morgan viewed that as an incremental step necessary to align the CAISO's policies with the limits in place in other organized electricity markets and with the understanding that the CAISO was going to move forward and simultaneously modify the default cost allocation methodology. After further consideration, J.P. Morgan supports the complete elimination of unsecured credit in the CAISO's market. However, if the CAISO ultimately decides not to eliminate the use of unsecured credit, J.P. Morgan believes that it is imperative that the CAISO immediately reduce the unsecured limit to $50-100 Million and modify its default allocation methodology to allocate such costs to those that rely on unsecured credit. Finally, J.P. Morgan acknowledges and appreciates the CAISO's commitment to revisit the use and level of unsecured credit after the implementation of Payment Acceleration, as part of the consideration of a revised loss sharing mechanism, and implementation of MRTU.

Guarantees From Foreign Entities

J.P. Morgan supports the CAISO's recommendation regarding the conditions that must be satisfied in order to accept foreign guarantees. Specifically, J.P. Morgan agrees with the CAISO's proposal to 1) establish foreign guaranty limits of $5 million to $25 million for entities with a credit rating of A-/A3 or above; 2) not accept guarantees from entities with a credit rating of BBB+/Baa1 or below; and 3) apply less restrictive criteria for Canadian Guarantors (although requiring Canadian provincial utilities to waive any claims of sovereign immunity and submit to the jurisdiction of U.S. courts).

Affiliate Guarantees

J.P. Morgan continues to support the CAISO proposal to draft a Form Guaranty that requires a Guarantor backing the activities of one Affiliate to back all Affiliates participating in the CAISO market under the same Guaranty. J.P. Morgan agrees with the CAISO's recommendation that the Guaranty must have a limit sufficient to cover the aggregate Estimated Aggregate Liabilities of all of the Affiliates regardless of individual credit limits the Guarantor may wish to assign in the CAISO credit management system, and a provision that CAISO has the authority to reallocate individual Affiliate credit limits in the credit management system up to the Guaranty limit, to cover a potential call to an individual Affiliate for additional Financial Security.

Reduction in Cure Periods

J.P. Morgan continues to support the CAISO proposal to reduce the cure period for satisfying a request for additional Financial Security from five (5) Business Days to no more than three (3) Business Days. As stated previously, and even acknowledging that the CAISO has response time built into its collateral requests, J.P. Morgan would prefer to further reduce the cure period to one (1) or two (2) Business Days, recognizing that market participants have the ability to post cash immediately and then subsequently replace such cash deposits with financial instruments (e.g., letters of credit). J.P. Morgan notes that the PJM Interconnection recently approved a reduction to two (2) business days.

Credit Limit for Congestion Revenue Right Auction

J. P. Morgan continues to support the CAISO recommendation to reestablish the available credit limit for the CAISO Congestion Revenue Rights (CRR) auction at 90% of available credit. J.P. Morgan also supports the CAISO's new proposal that candidate CRR Holders that do not otherwise participate in the CAISO market not be excluded from this policy.

Financial Penalties

As stated in J.P. Morgan's previous comments, J.P. Morgan supports assessing financial penalties on market participants that are either late in paying their invoices or late in posting requested financial security. J. P. Morgan supports the imposition of the CAISO's proposed penalty levels in all instances of late payment/posting and the requirement to post cash in lieu of security after a third late payment.

Specifically, with respect to the CAISO's final proposal, J.P. Morgan supports:

1) assessing 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;
2) reducing a Market Participant's Unsecured Credit Limit to zero and requiring cash collateral for those Market Participants who pay late a third time within a rolling twelve month period;
3) funding a market reserve account that can be used to cover defaults with the above-identified financial penalties up 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; and
4) implementing the progressive discipline program, as outlined in the CAISO's final proposal.

<u>Credit Working Group</u>

J.P. Morgan continues to support the formation of a Credit Working Group (CWG) that can consult with and advise the CAISO on credit policy matters. As stated previously, J. P. Morgan believes that the CWG could be used to inform and/or develop CAISO positions prior to release of a CAISO Issue Paper or Straw Proposal. Use of the CWG in that manner may in fact expedite resolution of issues during the broader stakeholder process. Moreover, in order to build support for proposal, the CAISO may in fact want to utilize willing CWG members to present proposals to the broader stakeholder community. As to membership, J.P. Morgan believes that it is sufficient to rely on market participant expertise. Addition expert credit/risk management advice can be sought on an as-needed basis.

<u>Loss Sharing Mechanism</u>

As stated in its previous comments on this issue, J. P Morgan strongly supports CAISO changing its loss sharing/chargeback mechanism. J.P. Morgan does not support deferring this issue and does not see any material benefit in deferring action. More time and consideration will not make this issue less contentious, nor will it shed additional light on the issue. In fact, deferral will only increase risk to the market and may reduce participation in the CAISO's markets – results that will not support a successful implementation of MRTU.

J.P. Morgan recommends that the CAISO modify its default allocation methodology so that the costs of defaults are allocated to those that rely on unsecured credit. Alternatively, should, as J.P. Morgan recommends, the CAISO eliminate the use of unsecured credit in its markets, J.P. Morgan recommends that the CAISO allocate payment defaults to all market participants - rather than just creditors - as determined by each market participant's participation gross billings in the CAISO markets during the default month. J.P. Morgan believes that such a default allocation methodology is equitable, fair, and consistent with the practices of other RTOs. J.P. Morgan believes that continuation of the current loss allocation methodology is unjust and unreasonable and, especially in light of the current conditions in the financial markets, places an unfair burden on a subset of market participants.