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

Submitted by	Company	Date Submitted
Steve Greenleaf *(916) 802-5420*	*J.P. Morgan Ventures Energy Corporation*	*November 4, 2008*

General Comments

J.P. Morgan Ventures Energy Corporation (J.P. Morgan) appreciates this opportunity to submit comments to the California ISO (CAISO) on the CAISO's Straw 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, including the Calpine proposal to initially clear the Day-Ahead Market in advance of the Real-Time Market using final Day-Ahead Market schedules.

J.P. Morgan is concerned with the general direction of the CAISO's proposal, as detailed in the October 20, 2008, Straw Proposal. First, it is important to emphasize that J.P. Morgan does not view each of the individual elements of the CAISO's proposal in isolation, but as an entire package. While J.P. Morgan previously supported the general direction of the CAISO's effort, J.P. Morgan cannot support moving ahead on certain elements while deferring other critical elements. Specifically, J.P. Morgan does not support the CAISO's proposal to defer addressing the default allocation methodology while proposing to continue to permit use of unsecured credit (albeit at a reduced maximum threshold). J.P. Morgan does not believe these are separable issues and recommends that should the CAISO require net creditors to continue to shoulder the entire burden of defaults that the CAISO minimize such risk by eliminating the use of unsecured risk altogether. Consistent with that position, J.P. Morgan supports the comments made by Powerex on the October 27, 2008, credit enhancements conference call and the credit-related comments included in Powerex's letter to the CAISO Governing Board (see: http://www.caiso.com/206e/206e97b25d3e0.pdf) regarding MRTU implementation. Alternatively, and preferably, the J.P. Morgan recommends that the CAISO modify the default allocation methodology to allocate the cost of any defaults to all market participants, consistent with the practices in place in other organized electricity markets.

In conclusion, J.P. Morgan recommends that the CAISO not defer addressing the default allocation methodology, change the methodology as discussed above, and move forward with a comprehensive set of enhancements to its credit policy. As a less preferred alternative, J.P. Morgan recommends that the CAISO rebalance its set of proposed enhancements and, to the extent it retains the existing default allocation methodology, the CAISO should eliminate the use of unsecured credit in the CAISO's markets.

CAISO Response: CAISO shares JPMorgan's and other stakeholder concerns about deferring the loss allocation discussion while pushing forward with the proposal to set a lower maximum unsecured credit limit. However, 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 not be in a position to propose a change to the current loss allocation methodology at this time, but instead will continue discussion of this topic outside of the current credit policy enhancement stakeholder process. That being said, CAISO is of the view there is merit in bringing the current loss sharing policy into closer alignment with peers and that such a change could further align market participant interests toward the promotion of strong credit policies. However, CAISO recognizes the significant concerns that suppliers and other Market Participants have about this issue. Accordingly, CAISO is committed to a careful and thorough analysis of this issue and alternatives – including loss sharing's relationship with Payment Acceleration and unsecured credit limits – before potentially proceeding with any change.

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?

As a general matter, and in light of the exigent circumstances in the broader financial markets, J.P. Morgan supports more conservative unsecured credit limits. However, as stated above, J.P. Morgan recommends that the CAISO develop and adopt a balanced set of credit policy enhancements such that the inherent risks of participation in markets that allow the use of unsecured credit be borne equally by all market participants.

CAISO Response: See response to General Comments.

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?

J.P. Morgan supports the CAISO's proposal to use 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.

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?

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 agrees that it may not be possible to include by name all such possible restricted assets in the definition of Tangible Net Worth. However, J.P. Morgan continues to recommend that the definition of Tangible Net Worth specifically exclude known restricted assets, and recommends that the CAISO add the caveat that the CAISO can exclude "other assets the CAISO deems to be restricted or potentially unavailable to settle a claim in the event of default." That way, Market Participants are on notice and sufficiently aware that certain assets will be excluded from the determination of Tangible Net Worth and the CAISO can retain and exercise appropriate discretion when determining an entity's Unsecured Credit Limit.

CAISO Response: CAISO will further consider this recommendation, and believes it has significant merit.

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?

J.P. Morgan does not support the CAISO's straw proposal to reduce the current maximum amount of unsecured credit to $150 million. J.P. Morgan initially supported the CAISO's original proposal to reduce the Unsecured Credit Limit to $100 M (from $250 M) with the understanding that the CAISO was going to move forward and simultaneously modify the default cost allocation methodology. As it stands, if the CAISO chooses to defer addressing the default allocation methodology, then J.P. Morgan recommends that the CAISO eliminate use of Unsecured Credit. Alternatively, if the CAISO does decide to address the default allocation methodology, then, depending on the outcome of that effort, J.P. Morgan could support a maximum Unsecured Credit Limit of $100 M.

CAISO Response: See response to General Comments.

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?

While J.P. Morgan previously supported the CAISO's earlier recommendation to adopt rules similar to those in place in ISO-NE, J. P. Morgan can support the CAISO's new straw proposal to accept non-U.S. and non-Canadian guarantees if the CAISO adopts strict criteria similar to the more stringent standards in place in PJM and MISO and that are based on the Foreign Guaranty Benchmark. In addition, J.P. Morgan supports the CAISO's straw proposal to adopt MISO's maximum unsecured credit limits based on a minimum country rating and the guarantor's credit quality.

In addition, with respect to Canadian entities and as stated in J.P. Morgan's previous comments on this topic, to the extent not so otherwise provided and consistent with the rules in place in PJM, J.P. Morgan supports adding a requirement that provides that to the extent that any Canadian entities that are provincial utilities, the Canadian entities should be required to submit to the jurisdiction of US Courts and waive any claims of sovereign immunity. See http://www.pjm.com/committees/members/downloads/20070927-item-02b-oa-revisions-regarding-foreign-credit-guar.pdf]

CAISO Response: Noted. Credit staff will seek CAISO legal opinion regarding your comments about Canadian guarantees.

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?

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.

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?

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) Business Day, 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).

CAISO Response: Some stakeholders have expressed a concern that, because of internal business structure, they may not be able to respond as quickly as other Market Participants to a shorter posting period. In addition, the CAISO believes that a posting cycle shorter than the proposed three days may not further reduce the risk of a longer posting cycle but, instead, may create a burden on some Market Participants. Although CAISO currently believes the combination a shorter posting cycle and retention of a cushion in the liability estimate to cover response time for collateral calls may be sufficient at this time. The CAISO is open to continued discussion and analysis to see if risk can be reduced further by an even shorter posting cycle as you recommend.

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?

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 can also support the CAISO's proposal that candidate CRR Holders that do not otherwise participate in the CAISO market be excluded from this policy. In other words, J.P. Morgan supports a policy where market participants that participate only in the CAISO's CRR market be entitled to rely on 100% of the credit posted for the CRR market.

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?

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 latest straw proposal, J.P. Morgan can support:

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 require 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 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 straw proposal.

CAISO Response: Noted.

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?

J.P. Morgan supports the CAISO's straw proposal. See comments on (9) 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?

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.

CAISO Response: Noted.

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?

As stated in its previous comments on this issues, J. P Morgan strongly supports CAISO changing its loss sharing/chargeback mechanism to a *pro rata* allocation of a payment default 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. J.P. Morgan recommends that the CAISO closely examine the default allocation policies in place in the other organized electricity markets and the applicable and related FERC precedent, and proceed to develop and approve a CAISO default cost allocation methodology based on its findings.

J.P. Morgan is concerned that should the CAISO propose to retain the existing inequitable default allocation methodology, suppliers may be reluctant to participate (or more actively participate) in the CAISO's markets. Especially at the start of MRTU – when there may already be incentives for load-serving entities to self-schedule their resources into the market – the CAISO should not take any action that may diminish the liquidity of the CAISO's markets. In addition, should the CAISO continue to allocate the risk of payments default to only suppliers, to the extent that they do participate in the CAISO's markets, suppliers may be compelled to build in additional risk adders when bidding in to the CAISO's markets. While others may argue these conditions exist in the market today and suppliers continue to participate, J.P. Morgan cautions that the conditions that exist in both the electricity and financial markets today are not at all comparable to those that have existed over the past several years.

J.P. Morgan also disagrees with arguments that the risk born by net creditors/suppliers in the CAISO's markets is similar to the risk and responsibilities born by suppliers under bilateral contracts. That is simply not true. First and foremost, bilateral contracts are the result of arms length negotiations where both parties voluntarily agree to enter into a transaction and with full knowledge of the balance of risks/rewards. Second, when participating in the CAISO's markets, suppliers cannot choose, or directly assess the risk of entering into transactions with, their counterparties. In light of this fact, and as discussed above, suppliers must assess the risk of market participation and factor those risks into its market bids.

Finally, J.P. Morgan believes the best means to reduce market risk to *all* market participants is for the CAISO to move forward and implement some form of Payment Acceleration as soon as possible. Substantially reducing the CAISO's cash clearing timeline will reduce the risk of payment defaults to all market participants.

CAISO Response: See response to General Comments.

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?

J.P. Morgan agrees that these items should be removed from consideration.

CAISO Response: Noted.