Pacific Gas and Electric Company's Comments on the California Independent System Operators: Settlements and Market Clearing \ Scheduling Coordinator (SC) Credit Policy

PG&E appreciates the opportunity to provide comments to the California Independent System Operator Corporation (CAISO) concerning the CAISO's conceptual approaches to changes in its credit policies. PG&E is continuing to review the CAISO's proposals, and looks forward to continuing the discussion with the CAISO and other stakeholders as these changes take form and their implications are better known. As PG&E understands, the CAISO's proposal, in part, is in response to the November 19, 2004 FERC policy statement on credit issues. PG&E believes the CAISO has taken steps in the right direction by considering the practices of other participating ISOs around the country (ERCOT, IMO, MISO, NEISO, NEMMCO, NYISO & PJM). The CAISO's benchmarking exercise identified major differences in the settlement and billing cycles between the CAISO and other entities included in the study.[1] It provides a framework from which characteristics unique to the CAISO market structure, such as the timing of when meter data is available, can be identified. PG&E supports the CAISO's efforts to isolate and implement changes which ensure that equitable, fair and transparent credit policies are provided to both buyers and sellers in the CAISO's markets. PG&E is pleased to have the opportunity to comment on several aspects of the CAISO's credit policy proposals at this time. There are several other aspects of the proposals, however, that PG&E requests further clarification about, and will provide further comment about once the CAISO has had the opportunity to respond.

PG&E Questions:

The following questions, many of which are similar to those PG&E has previously raised with the CAISO, arise from the November 10, 2004 paper entitled SC Credit Policy Changes Under Consideration, the November 30, 2004 SC credit policy stakeholder discussion and the October 25, 2004 whitepaper on ISO payment acceleration. References to slides are to the overheads used in the presentation made at the November 30 stakeholder discussion.

- Slide 11 – Credit Limits – KMV Default – What is the process that the CAISO will follow if it can't get KMV default probability for a particular entity?
- Slide 10 – Credit Limits - Consistent with other ISOs – what particular aspects of the proposed policy are consistent with other ISO practices?
- Slide 10 – Credit Limits – Tangible Net Worth – What is the underlying reason for using Net Worth as a basis for granting unsecured credit line? How will the CAISO handle cases in which a non-investment grade counterparty has a large

[1] Whitepaper, pg 5. Comparison with other ISO/RTO's

Net Worth number but has a poor cash flow from operations? How will the CAISO take into account an entity's liquidity in granting a credit line?

- Slide 12 – Credit Limits – What rating is the CAISO planning to use from S&P – senior ***unsecured*** debt; senior ***secured*** debt; or issuer rating? What if a company doesn't have a senior unsecured debt rating because it has issued no senior unsecured debt – how will the CAISO handle this issue? How often will the CAISO perform credit reviews? What will it do if the SC has no S&P rating?
- Slide 11 – Credit Limits – Separate Standards – PG&E agrees that credit risk arises from both GMC and market, but would like to know how the CAISO intends to bill these two types of services?
- Slide 17 – Credit Limits – what is the basis for the % of net worth associated with the rating score?
- Slide 19 – Credit limits – what is the basis for the 35% factor to take into account the concentration limit in A/R? What is the current concentration in A/R? What has the highest number been over the last 12 months? How long did it stay at the number?
- Slide 23 – ISO Approved Agreements – How will the CAISO reach agreement with its stakeholders on a standard form L/C?
- Slide 24 – Credit Insurance – What does the CAISO expect would be covered with credit insurance – all unsecured credit, all A/R, a portion of A/R, etc?
- Slides 31 to 35 – Security Posting Requirements - What risk would the CAISO take on if it used a simple method to compute exposure for posting? For example, use 2 times (once the new system goes in) the highest settled amount from the previous 12 months. The formula would then be [2*Highest Monthly Bill less the Unsecured Credit Line – posted collateral = Collateral to post]. The formula could be set every 12 months unless there was a sharp increase in monthly charges incurred by the SC. What would some of the benefits be if the CAISO went to a simplified approach? What would be some of the pitfalls?
- Slides 37-40 – Unsecured Obligation Penalty – How complicated would this penalty process be to administer? How likely is this to result in compliance with CAISO requests? How would the simplified method mentioned above alleviate the need for a penalty process?
- What is meant when the CAISO uses the term "undue credit risk" in the October 25, 2004 White Paper "California ISO Payment Acceleration Project"

PG&E Comments:

<u>Settlements and Billing Payment Calendar Reduction</u>

Conceptually, PG&E agrees with the CAISO that the current Payment Calendar may inhibit resource availability from out-of-state generators and could possibly expose market participants to unacceptable risk in the event of defaults or bankruptcies. From a practical perspective, PG&E suggests that before efforts are initiated to accelerate the payment calendar from the current practice (from 85 days for payments and credits to 20 days after the end of the trade month) that more quantitative studies be required to allow parties the opportunity to understand the expected level of accuracy associated with the estimation process--as presented by the ISO in its October 25, 2004 Whitepaper "ISO Payment Acceleration Project". PG&E is concerned that the ISO's proposal may resolve one concern, earlier payments and credits to the market, and create a new problem that could yield unreasonable cash swings for market participants. PG&E believes that unreasonable cash swings for market participants are primarily due to volatility and the monetary size of charge types, such as minimum load cost, unaccounted for energy and neutrality. PG&E's could only fully support the CAISO's proposal to seek approval of an accelerated payment schedule after the ISO has established that the proposed payment reduction (20 day after the end of the trade month) will function successfully.

Stakeholder Process

PG&E appreciates the opportunity to specifically comment on the issues relating to the Settlements and Billing Payment Calendar Reduction and the SCID Specific Security Postings. PG&E has previously presented several questions concerning issues in the proposal related to Risk and Liability, and requested that the CAISO provide quantitative analysis demonstrating the type of accuracy that can be expected from its accelerated invoice payment proposal. PG&E looks forward to the CAISO's responses and the opportunity to further comment on those issues once the CAISO has provided clarification. Finally, PG&E would further emphasize the importance of developing recommendations through active and participatory stakeholder involvement.

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