Comments of Pacific Gas and Electric Company (PG&E)

Submitted by	Company	Date Submitted
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Subject: Credit Policy Enhancements Straw Proposal

Introduction

Pacific Gas and Electric Company (PG&E) appreciates the opportunity to provide these comments on the CAISO's October 20, 2008 straw proposal outlining various proposed credit policy reforms.

As PG&E stated in its comments of October 7, 2008, the timing of implementation of revised CAISO credit policies is a key issue for PG&E since major changes to the CAISO's markets are expected to take place on February 1, 2008 with the initial implementation of MRTU. As a major change in the markets overseen by the CAISO, MRTU can be viewed as increasing credit risk to market participants. This change, combined with increasing credit risks resulting from the ongoing credit crisis in financial markets leads PG&E to conclude that credit policy reforms should be implemented as soon as is reasonably practical and <u>no later than the go live date for MRTU.</u> The current proposal to implement credit reforms in March of 2009 does not align with the current MRTU go live date. Therefore, the CAISO should align implementation of enhanced credit policies with implementation of MRTU.

<u>CAISO Response</u>: The CAISO understands PG&E's concerns about the implementation schedule of these credit policy enhancements. The CAISO will do its best to align the implementation of the recommended ISO credit policy enhancements from the straw proposal with the implementation of MRTU. Certain proposed enhancements such as financial penalties for late payers and late posters of financial security as well as any changes to the loss sharing methodology (if any) are unlikely to be in place with the rollout of MRTU.

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?

   PG&E Response: PG&E is generally in favor of proposed changes that result in more conservative unsecured credit limits.

   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?

   PG&E Response: PG&E supports the CAISO's proposal to use the lowest Credit Agency Issuer Rating when two or more issuer ratings are available. PG&E also supports use of the lowest equivalent long term rating if only a short term rating is available. PG&E also recommends that the CAISO consider tariff language which allows it to call for collateral if there is a material adverse change in the financial condition of a Market Participant.

   CAISO Response: Noted. Section 3.4 of the BPM for Credit Management already contemplates material changes in financial condition. Market Participants are obligated to report material changes in financial conditions to the CAISO. The CAISO may also learn of material changes in financial conditions in the financial press or other media reports. As part of CAISO's qualitative assessment process in assigning an Unsecured Credit Limit (UCL), the CAISO can reduce a Market Participant's UCL which could result in an immediate collateral call.

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 <u>exclude</u> these types of assets in the definition of Tangible Net Worth as originally presented or consider them as part of the <u>qualitative assessment</u> in step 8 of the eight-step process as presented in the straw proposal?

   PG&E Response: PG&E agrees 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. The CAISO should specifically exclude these types of assets in the definition of Tangible Net Worth as originally presented.

CAISO Response: Noted.

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?

PG&E Response: Yes, PG&E supports 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. However, as stated above, PG&E continues to believe that the reduction in the current maximum amount of unsecured credit should be implemented concurrent with initial implementation of MRTU. PG&E also suggests that the CAISO review the maximum unsecured credit limit on a yearly basis.

CAISO Response: Noted. The maximum Unsecured Credit Limit will be reduced on a pro-rata basis with the release of Payment Acceleration. The CAISO will continue to monitor after the release of MRTU. PG&E's suggestion to review the limit on an annual basis is worth further consideration.

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?

PG&E Response: Yes.

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?

PG&E Response: PG&E supports the CAISO's continued development of the Affiliate Guaranty as outlined in the CAISO's proposal of October 20.

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?

   PG&E Response: PG&E supports a policy change that would reduce the time allowed to post additional security in the event of a collateral call. However, PG&E continues to believe that even three business days is an excessive time to respond to a collateral call, particularly in light of the increased potential for price volatility and collateral calls under MRTU's more complicated market structure. As we stated in our comments early in October, three days also seems excessive since four of the other six ISOs/RTOs have a two-day requirement. Although PG&E can accept the CAISO's proposal to reduce the time to post additional Financial Security to three (3) Business Days for the time being, we continue to strongly recommend that the CAISO reduce the time that market participants have for posting required Financial Security to one (preferred) or two business days (acceptable). If the CAISO does not adopt this proposal, PG&E recommends the CAISO revisit this policy through the CWG within six months of MRTU implementation.

   CAISO Response: Noted. With the cushion built into the EAL to cover the collateral posting response time, CAISO is unsure if reducing the posting period to one or two days (versus the proposed three days) will provide material additional benefits or further reduce the price volatility risk you describe. CAISO also must balance the desire for a significant reduction with two factors: (1) time to accommodate the EAL dispute process and (2) response times within some entities that have indicated a substantial reduction in the response time does not allow sufficient time for internal approvals for additional collateral. However, as stated in the straw proposal, the CAISO is committed to reassessing this policy once we gain some experience with the reduced posting requirement.

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?

   PG&E Response: PG&E supports the ISO's straw proposal to limit the amount of collateral for a CRR auction to 90% of available credit. PG&E agrees that Candidate CRR Holders that do not otherwise participate in the ISO market should be excluded from this policy.

   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?

PG&E Response: PG&E generally agrees with the CAISO's proposal to assess financial penalties on Market Participants who are late in paying their invoices. PG&E supports the CAISO proposal for reducing a Market Participants Unsecured Credit Limit to zero if the Market Participant is late in paying two times during a rolling 12 month period. PG&E can accept the CAISO proposal to limit Market Participants to 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. However, limits on penalties should be periodically review by the CWG based on market participant behavior. PG&E does not support funding a market reserve account with 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. Penalty revenues should be applied as a credit toward the GMC revenue requirement in the subsequent year. PG&E supports the immediate implementation of the suggested progressive discipline program.

CAISO Response: Noted. Your suggestion to review penalty limits is worth further consideration. As might be expected, stakeholders have differing viewpoints as to whether penalties should be used to fund a market reserve account or be used to reduce the GMC revenue requirement. Because financial penalties will not be in place until after the rollout of MRTU, there's time to further discuss alternative proposals and design the final solution. CAISO does believe that funding a market reserve account, to a reasonable level such as $5 million can provide substantial benefits to all market participants. While a strong credit policy should mitigate the likelihood of payment defaults, having a funded market reserve account could prevent short-payments to suppliers (under today's loss allocation provisions) or chargebacks to all market participants (if the loss allocation provisions are changed), and the attendant market concerns such would trigger.

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?

    PG&E Response: PG&E generally agrees with the CAISO's proposal to assess financial penalties on Market Participants for not posting Financial Security within the posting period. PG&E can accept the CAISO proposal to limit Market Participants to 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. However, limits on penalties should be periodically review by the CWG based on market participant behavior. PG&E does not 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. Penalty revenues should be applied as a credit toward the GMC revenue requirement in the subsequent year. PG&E supports the immediate implementation of the progressive discipline program similar to the one described for late payers for failing to post on time.

    CAISO Response: See response to question 9.

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?

    PG&E Response: As stated in earlier comments, PG&E supports the creation of a CWG as a means to formalize the CAISO's approach to managing credit policy change. A Credit Working Group could add value to the existing process by leveraging the expertise of technical experts for the purpose of revising and updating CAISO credit polices as market and credit conditions change. A CWG could also provide technical input concerning any necessary changes to the BPM for Credit Management.

PG&E agrees with the CAISO's conclusion that any working committee requiring independence, authority and control over credit policy is unlikely to be acceptable. The CAISO has previously entertained application of formal committees with sector voting structures. These efforts have failed to produce a consensus.

The structure of the CWG need not be formal and participation should not be limited; however, to maximize effectiveness, the CAISO should encourage participation from stakeholders, including representatives of regulatory bodies, with proven or demonstrable expertise in credit risk assessment or credit policy expertise developed through industry experience. The CAISO should allow for limited inclusion of credit professionals from outside of the power industry as advisors since they made provide useful and constructive perspectives on how to manage credit risks. However, PG&E suggests that a majority of CWG participants should be professionals from inside of the power industry who are stakeholders in the CAISO and support the CAISO's markets.

CAISO Response: Noted. CAISO will consider all stakeholder comments on this matter and work to arrange a CWG for future credit policy changes.

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?

PG&E Response: As PG&E stated in its comments of October 7, 2008, PG&E is not persuaded that the existing methodology, which allocates any payment defaults to net creditors, creates a disincentive for suppliers to participate in CAISO markets nor does it believe that net creditors bear a disproportionate share of the risk under the existing methodology.

PG&E observes that suppliers bear default risks under bilateral trading and sales arrangements. In fact, for most markets it is the seller, and not the buyer, who assumes the credit risk whenever a credit sale is made. This commercial practice has not discouraged sellers from entering into bilateral contracts; PG&E sees no reason why bearing a similar default risk for sales into CAISO markets would discourage participation in those markets. The existing loss sharing/chargeback mechanism has been in effect for several years. If the CAISO has evidence that the existing practice discourages participation in its markets, it should present those findings to stakeholders.

PG&E believes that other credit policy reforms being proposed through this stakeholder process – many of which PG&E supports - will be effective reducing default payment risks for net creditors. Given this, PG&E is not convinced that a change in the current loss sharing /chargeback mechanism is warranted.

CAISO Response: Noted. CAISO strives to balance the interests of all Market Participants. CAISO is sensitive to the widely disparate views on this issue. CAISO also recognizes that it is the only ISO/RTO where suppliers are subject to the risk of payment default, long settlement cycles and high unsecured credit limits. CAISO is committed to a careful and thorough analysis of this issue before potentially proceeding with any change.

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?

PG&E Response: Yes.

CAISO Response: Noted.