

## Stakeholder Comments Template

### Subject: Credit Policy Enhancements Straw Proposal

Submitted by	Company	Date Submitted
Gifford Jung 604-891-6040	Powerex Corp.	November 4, 2008

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](mailto: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**.

*Powerex appreciates the opportunity to provide these comments on Credit Policy Enhancements.*

*Powerex strongly supports the CAISO in its efforts to update its current credit policies, which were implemented in 2006. The CAISO should seek to align its credit policies with other ISO's in light of current credit crisis and in line with the experience of other ISO's. All the other ISO's have a loss sharing mechanism that allocates the risk across all market participants and they are seeking to further refine their credit policies to reflect issues raised based on their default experience in the past year as well as in response to the current credit crisis.*

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?

*Powerex is in favor of the ISO proposal for more conservative unsecured credit limits. However if the default loss sharing mechanism is not changed, Powerex strongly supports a fully collateralized market until the default loss sharing mechanism is changed to a more fair allocation among market participants.*

CAISO Response: CAISO is very much aware of Powerex's position on loss sharing and its relationship to Payment Acceleration and lower unsecured credit limits. CAISO is making strides toward addressing Powerex's concerns with continuing development of the Payment Acceleration project as rapidly as possible, and by moving in the direction PowerEx requests with regard to unsecured credit limits. Additionally, CAISO recognizes the importance to PowerEx of changes in the current loss sharing methodology, and is not abandoning this matter, but will continue to discuss this matter with stakeholders over the coming months through the Credit Working Group.

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?

*Powerex is in general agreement with the straw proposal on this issue.*

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?

*Powerex supports the proposal as outlined in Section 3.2 in the Straw Proposal dated October 20, 2008 and specifically that "the ISO will exercise its good, prudent business judgment when evaluating types of risk assets...when determining whether a Market Participant's UCL should be reduced..." Currently there is not sufficient information to make an assessment as to whether this should be accomplished by deducting these assets from TNW or whether the adjustment should be proposed under the qualitative assessment step. We would request additional information on this and an example as to how this might be applied to a Market Participant under each scenario.*

CAISO Response: Noted. After considerable internal discussion, the CAISO may choose a combination of the two proposals as a means of addressing issues in this area. As requested, the CAISO will develop an example in its next paper in order for stakeholders to better understand the issues and challenges around this proposed enhancement.

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?

*Powerex does not support the straw proposal for a maximum unsecured credit limit of \$150 million. Without an equitable sharing of default loss among all market participants, the maximum unsecured credit limit should be reduced to zero or a nominal amount for all market participants. With an equitable sharing of default loss, Powerex would support a \$100 million maximum unsecured credit limit prior to the implementation of Payment Acceleration.*

*An alternative would be unsecured credit would only be available to those market participants that are subject to the loss sharing risk and all other market participants would only have a nominal amount of unsecured credit available to them. For example, net creditors would be eligible for up to \$100 million of unsecured credit and all other market participants would be eligible for a maximum of \$10 million of unsecured credit.*

*Powerex notes that there is a dichotomy that exists in the current stakeholder process where “net payers” have an interest in maintaining high credit limits in order to maximize their unsecured credit while the impact of significantly higher potential losses due to the high unsecured credit limits is not a concern to “net payers” as “net payers” do not share in ultimate losses. This situation is clearly inequitable and if it is sustained will impact the ability of “net creditors” to supply the ISO due to credit concerns. Why do “net payers” who have no responsibility in sharing losses of the ISO, have a say in the ultimate structure of the credit policies?*

*CAISO Response: See response to question 1. CAISO also recognizes and sees the value in changes to the loss allocation methodology to align interest among all Market Participants to support strong credit standards.*

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?

*Powerex is in general agreement with the straw proposal on this issue. While we are generally in favour of lower unsecured credit limits across the board, the CAISO should consider that the MISO maximum unsecured credit limit is \$75 million and accordingly, the limits for foreign guarantees are lower. Introducing the MISO scale in the CAISO would mean disproportionately lower unsecured credit limits for foreign entities in the ISO when compared to MISO and others. Note that the maximum unsecured credit limit in PJM is twice that of MISO and accordingly the maximum foreign guarantees permitted are twice that of MISO. Note also that both PJM and MISO are significantly larger markets than the CAISO by approximately 3x and 2x respectively.*

*Powerex seeks additional clarity from the CAISO on whether there will be any changes to the current format and requirements of the Canadian guarantee. Powerex also asks whether the CAISO has considered amending the current language to treat both Canadian and US guarantors in the same manner.*

CAISO Response: The CAISO proposal treats Canadian and U.S. guarantors the same manner. CAISO legal has recently updated CAISO's standard guaranty language to include provisions related to sovereign entities. Other than that, the CAISO anticipates no other material changes that would affect Canadian guarantors. This straw proposal defines the criteria CAISO proposes using in assigning unsecured credit limits for non-U.S. and non-Canadian entities and is modeled after similar policy implemented by PJM and pending at MISO. CAISO recognizes there may be some residual risk in extending its guaranty policy to include "foreign" entities. Accordingly, CAISO chose the lower unsecured credit limits as proposed by MISO not so much to be correlated with the unsecured credit they would provide a "domestic" entity but rather as a means to limit the downside risk of accepting financial security from these new entities. It should be noted that CAISO is evaluating an SCE proposal that will further reduce the credit risk of a foreign guaranty by limiting unsecured credit to those guarantors with a credit rating of A- or above. This proposal is more conservative than both the PJM and MISO approaches.

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?

*Powerex has no real issues with the development of an Affiliate Guaranty, however, we believe that cross default clauses between affiliates and the ability to net positions in the event of a default would be an effective means of potentially reducing CAISO exposure and limit potential gaming opportunities between affiliated counterparties. These clauses are generally quite common in bilateral energy enabling agreements. If a cross default clause were used between affiliate companies and the ISO, in the event that one affiliate defaulted in its obligations to the CAISO, the CAISO could declare other affiliates in default as well. The ability to net positions across affiliates in this scenario would allow the CAISO to net and setoff amounts owed to and from the CAISO between affiliates, thereby potentially reducing the exposure to the group as a whole.*

CAISO Response: CAISO legal will be asked to evaluate this proposal, but there is a strong likelihood that this would run afoul of regulated/unregulated requirements.

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?

*Powerex supports the straw proposal on this issue on the understanding that the CAISO would re-visit this issue at a future date to determine if the time to post additional Financial Security could be reduced further.*

CAISO Response: 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?

*Powerex is in general agreement with the straw proposal on this issue. However, Powerex believes that the CAISO should consider evaluating EAL on a frequent basis, preferably daily.*

CAISO Response: Noted. With the availability of a new CAISO credit management system with MRTU, CAISO will have the ability to evaluate EAL on a daily basis.

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?

*Powerex is in general agreement with the straw proposal on all elements of this issue except for the cap of \$5 million to the market reserve account. Powerex does not understand why the excess amounts should go towards reducing GMC revenue requirement for the benefit of all market participants when the current loss sharing mechanism allocates all the risk of default to net creditors. In addition, given the size of the defaults we have been experienced in other CISO markets, we do not believe that a cap is appropriate at this time.*

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?

*Powerex is in general agreement with the straw proposal except for the cap on the market reserve account (see comments 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?

*Powerex would foresee that the Credit Working Group would look at each credit issue raised by stakeholders within the existing stakeholder process or referred to it by management. The Credit Working Group would investigate the issue, hold discussions much like the current stakeholder process and then provide alternatives for consideration through the regular stakeholder process. Powerex wouldn't foresee involving outside parties unless the working group determined it was appropriate to engage outside consultants to opine on specific issues and or to conduct benchmarking activities.*

*Powerex further suggests that membership within the Credit Working Group should be weighted towards those market segments that bear the credit risk.*

CAISO Response: CAISO will consider all stakeholder comments on this matter and work to arrange a Credit Working Group 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?

*Powerex does not see any benefits to continuing with the current loss sharing mechanism and believes that the CAISO should aggressively seek to change the current policy. The current loss sharing policy is not equitable and is not in line with other ISOs. It encourages extreme opposing views where credit is concerned as those participants responsible to pick up losses have a vested interest in granting limited or no unsecured credit whereas those that are not responsible for any portion of the losses have a vested interest in loose credit policies and high unsecured credit limits. In addition, if the status quo is maintained, net creditors will not be incented to sell into the CAISO market and may/will cap their participation potentially resulting in higher prices and reliability issues.*

*Powerex believes that the CAISO loss sharing policy should allocate the risk of losses among all market participants like all other ISO's and clearing houses. If the risk of losses is not shared equitably among all market participants then those market participants that do not share in the loss should not have access to any significant unsecured credit. Having a loss sharing policy that allocates the risk of loss among all market participants places all participants on equal footing and aligns interests.*

*Without an equitable sharing of losses among all market participants, it will be difficult to come to a consensus on credit policy issues like unsecured credit limits. Those market participants not exposed to the loss risk would advocate high unsecured credit limits and those market participants exposed to the loss risk would advocate a fully collateralized market.*

*At a high level, we consider the most equitable manner in which to share losses is based on a participant's pro-rata activity in the market. In most ISOs this is accomplished by taking the gross value of purchases and sales for a specified period for that participant compared to the gross value of purchases and sales in the ISO over the same period which period is usually the period during which the default occurs.*

*Powerex notes that an equitable loss sharing mechanism would also incent all participants to work together to implement other initiatives, like Payment Acceleration, to reduce credit exposure from non-payment for all parties.*

*CAISO Response:* *See response to question 1.*

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?

*Powerex agrees with the CAISO decision to remove the market funded reserve account and credit insurance from further consideration. While we concur with this course of action at the present time, we do feel that the CAISO should revisit and/or explore potential options in this area every couple of years either through its stakeholder process or via the Credit Working Group.*

[CAISO Response: Noted.](#)