Stakeholder Comments Template

Subject: Credit Policy Enhancements Straw Proposal

Submitted by	**Company**	**Date Submitted**
Eric Leuze	*Reliant Energy*	*November 6, 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. 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**.

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?

   Reliant Energy supports more conservative credit policies that are defined and administered without preference or undue discrimination. The recent turmoil in financial markets demonstrates that credit ratings are imperfect criteria by which to evaluate default risk. In addition to the implementation of payment acceleration as soon as possible, the CAISO should implement several changes to its credit policy to reduce credit risk, as further discussed below.

   Ideally, that the proposed enhancements to credit policy developed through this stakeholder process would be in place when MRTU is scheduled to go live on February 1, 2009. Reliant Energy notes that under the Straw Proposal, these changes would be implemented four weeks later on March 3, 2009. The CAISO should assign a high priority to preserving this schedule.

   CAISO Response: CAISO recognizes that credit ratings alone tend to lag actual and market perceptions of default risk and accordingly the inclusion of the Moody's KMV expected default frequency into the credit limit setting process is a useful supplement ot this process.

CAISO recognizes the sense of urgency among many stakeholders to ensure that credit policy enhancements are implemented concurrent with or as soon as possible after MRTU startup, and CAISO will endeavor to ensure this happens, potentially asking for expedited FERC action on a filing in order to align to align our schedule with the release of MRTU.

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?

   Reliant Energy supports the use of the lowest Credit Agency Issuer Rating when two or more long term ratings are available. However, Reliant does not believe that fixed definitions of how short term ratings can be converted to long term ratings is a useful approach. In the future, Reliant advocates that the CAISO develop additional objective credit analysis to enhance credit rating data and to be used when long term unsecured credit ratings do not exist.

   <u>CAISO Response</u>: Current credit policy allows for the use of short-term ratings when an issuer rating is unavailable. The existing methodology uses the middle equivalent long-term rating. This proposal simply advocates the use of the lowest rating to be consistent with the conservative bias being proposed with other proposed credit policy enhancements.

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?

   Reliant Energy supports more restrictive policies regarding unsecured credit limits, and the CAISO's proposal to exclude patents, trademarks, franchises, intellectual property and goodwill from the definition of Tangible Net Worth. Reliant Energy would also support the addition of restricted cash to the listing of specifically excluded assets.

   Reliant Energy is concerned that additional modification of the definition of Tangible Net Worth is not appropriate, and that the CAISO should not include a blanket exclusion of other assets (such as derivatives) from the calculation of Tangible Net Worth. Instead, the CAISO should perform an objective credit analysis of each participant seeking unsecured credit, and if the CAISO concludes that certain assets are not indicative of the participant's ability to meet its payment obligations, then additional adjustments can be performed in step 8.

CAISO Response: CAISO notes Reliant's agreement with the exclusion of intangible and restricted assets from the Tangible Net Worth (TNW) calculation. CAISO experience shows that restricted assets in some instances can be a significant source of volatility in the TNW calculation, specifically, the net of restricted assets and any matching restricted liabilities (particularly deriviatives) can fluctuate dramatically from one reporting to the next. This may result in a Market Participant being eligible for a high unsecured credit during one reporting period but no unsecured credit the next (even when conditions may change within the reporting the period). Because of this, CAISO believes it prudent and its bet business judgment to err on the side of conservatism and exclude derivative assets. Appropriate considerations for this situation may also be reflected in step 8 of the unsecured credit limit setting process.

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?

   Part of the CAISO's rationale for revising the proposed maximum Unsecured Credit Limit to $150 million appears to be that it is more likely that a $100 million limit may be exceeded when the impact of CRRs and other MRTU market charges are considered. How much unsecured credit a participant might need seems less important than how much risk that participant's positions might impose on the market, particularly given the CAISO's planned deferral of the correction of loss allocation rules.

   Reliant Energy supports the CAISO's original proposal to reduce the Unsecured Credit Limit to $100 million.

   CAISO Response: CAISO is committed to reducing maximum unsecured credit limits to reflect practices of peers and perceptions of increased risk, with appropriate consideration for the impact of these reductions on CAISO participants. A number of stakeholders agree with Reliant in that CAISO's maximum unsecured credit limit being $100 million or less. Some advocate no unsecured credit and that CAISO have a fully collateralized market. CAISO plans to further reduce its proposed $150 million cap on a pro rata basis when Payment Acceleration is implemented (shortly after MRTU startup). It will further assess unsecured limits after seeing MRTU's impact on a Market Participant's EAL and as part of the discussion related to the loss allocation rules.

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?

   Reliant Energy is not opposed to the use CAISO's acceptance of foreign guarantees so long as criteria similar to PJM and MISO are applied, nor does Reliant disagree with the CAISO's adoption of the MISO approach to defining maximum unsecured credit limits, subject to clarification of the following questions:

1) Is the CAISO proposing that foreign guaranties not be required to be rated by at least one rating agency?
2) Can a foreign guaranty from a guarantor with a rating less than BBB+ exceed 50% of the participant's total Financial Security?

CAISO Response: Consistent with PJM's requirements for a foreign guarantor and foreign guaranty as published in the straw proposal, CAISO would require a foreign guarantor to be rated by at least one of accepted rating agencies as specified in the BPM for Credit Management. Additionally, a foreign guaranty from a guarantor with a rating less than BBB+ may not exceed 50% of the guarantor's total Financial Security. With respect to this last point, CAISO is considering an SCE proposal that foreign guarantees only be accepted from guarantors with a rating of A- or higher.

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?

   No comment at this time.

   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?

   Reliant Energy supports a reduction in time to post additional Financial Security to three business days, so long as the CAISO continues to provide timely responses to disputes regarding the accuracy of the data underlying the requested amount of Financial Security.

   CAISO Response: Noted, and CAISO will continue to provide the opportunity to review material presented by Market Participants to dispute the need for additional collateral within the required posting period. As currently, if the dialogue needs to continue beyond the posting period, the Market Participant must post the collateral by the end of the post period, and CAISO will then return the collateral if CAISO concludes the Market Participant has appropriately demonstrated the increased collateral is unnecessary.

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?

   Reliant Energy does not oppose this policy, so long as each participant is treated without preference or undue discrimination. Whether or not a participant has a collateral obligation associated with a CRR auction should not affect the timing or the amount of a request for additional Financial Security. The CAISO should provide an updated *assessment of the adequacy of its CRR credit policies in light of recent credit market developments and the recent defaults experienced by PJM.*

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?

   Reliant Energy supports the development of incentives to fulfill the tariff obligation to pay invoiced amounts on the Payment Date, but does not support the proposed reduction of an Unsecured Credit Limit to zero based on late payments. The conceptual elements of the CAISO's Straw Proposal for a reserve account seem reasonable.

   CAISO Response: Noted. Stakeholders generally recognize the need for harsher penalties for chronic late payers. Missing a payment due date three times or more may be indicative of a deeper problem which puts the rest of the Market Participants at risk of delayed payments or short payments as the result of a payment default. Reducing a chronic late payer's unsecured credit limit and requiring them to post cost eliminates the risk of payment delays and short pays by having a ready pool of cash collateral to draw on in the event of a late payment. Does Reliant propose an alternative penalty for chronic late payers for CAISO and stakeholder consideration?

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?

Reliant Energy supports the development of incentives to assure that Market Participants respond to requests for additional Financial Security.

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?

    Reliant Energy believes that membership to the Credit Working Group should be open to any Market Participant, but each representative on the Working Group should meet reasonable criteria for education and experience developed by the CAISO with stakeholder input.

    CAISO Response: Noted. CAISO would expect that it would be in the interest of Market Participants to send representatives with appropriate interest, background, and responsibility for credit matters, but in keeping with other CAISO stakeholder processes, CAISO would not exclude participants.

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?

    Loss sharing rules in other electric markets, and fairness, both argue for a change in the loss sharing policy to make those Market Participants owing the market as well as those owed by the market responsible to make up a default by another participant on a pro rata basis. This market risk arises only when a creditor defaults. No risk is imposed on the market by a Market Participant with a debit balance that goes bankrupt or is illiquid – yet they are the only Market Participants who bear the burden of a default by a Market Participant with a credit balance. This imposes asymmetric risk on Market Participants who are net suppliers to the CAISO market. There is no justification for this asymmetry. Fundamental risk/return concepts dictate that all Market Participants should share in the credit loss based on their participation in the market.

    Whether or not an additional Charge Code is required should be of no relevance in determining whether to proceed with a change to conform loss sharing policy to other markets so that default risk is equitably assigned. A manual charge code and work around should be used if necessary.

    CAISO Response: The CAISO is committed to exploring loss sharing and related credit policy enhancements that would allow the risk of participating in the CAISO market equitably by all Market Participants. The CAISO pledges to continue this discussion outside of the current credit policy enhancement stakeholder process.

Manual workarounds have been discussed internally at CAISO, but at present are not seen as viable. This can be explored further during the course of our continued discussions on this important topic.

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?

    Reliant Energy is not opposed to elimination of credit insurance from further consideration, but believes that a market funded reserve account as discussed in Question 9 and 10 is appropriate.

    CAISO Response: Noted.