

CAISO's Responses to Comments on the Proposal to Reevaluate CRR Credit Requirements under Extraordinary Circumstances

1. DC Energy Comments

DC Energy supports proper collateralization of CRRs under Extraordinary Circumstances. However, DC Energy opposes CAISO using models to set collateral requirements for the following reasons:

Difficulty of implementation:

- Currently the DAM team reserves three hours to run the DAM. Given the CAISO intends to model every hour of the Extraordinary Circumstance (at least according to comments on last Friday's call), how will the CRR team model a 30 day Extraordinary Circumstance starting 20 days in the future? Presumably the model run that attempts to predict the future will be substantially more complicated than the DAM run as the CAISO will have to predict fuel prices, changes in participant behavior (both internal and external), and weather at a minimum. Can the CAISO realistically run these simulations? Does CAISO have the expertise to predict future values of the various inputs required for the model? Does CAISO have the resources required to run, validate, and interpret what could be 30 days, or perhaps more, worth of DAM models results per Extraordinary Circumstance? The CAISO must balance the appeal of collateralization-to-model with the difficulty of

implementation of such a concept.

- Market prices are better than modeled prices for setting collateral requirements:

One area that the CAISO does have extensive expertise in is the running of auctions. Further, the CAISO already leverages auction pricing to set credit requirements. If the CAISO were to run reconfiguration/balancing auctions with enough frequency, these would reflect the impact of the extraordinary events as they are announced. In effect, the market prices would capture the collective information of the market in addition to the CAISO's view of the grid under Extraordinary Circumstances.

An added benefit is that the incremental effort required to run the additional auctions should be substantially smaller than that required to develop and implement collateralization -to-model.

- Even under the assumption that collateralization-to-model is the right approach, CAISO may not be the right entity to implement it:

If the the drivers for the Extraordinary Circumstance are made public, and the resulting values used for collateralization-to-model are also made public, it follows CAISO should outsource the modeling function to a third party with the appropriate expertise. CAISO should issue an RFP and retain at least two independent third parties to separately evaluate the impact of the Extraordinary Circumstance.

If the CAISO choses to forge ahead with an in-house collateralization-to-model approach, the CAISO should be transparent enough about the information and methodology used to derive

Extraordinary Circumstance collateral requirements that CRR holders would be able to estimate those requirements themselves.

CAISO RESPONSE: CAISO appreciates the suggestion of the market price approach. Currently, CAISO already runs an annual auction followed by 12 monthly auctions. To attain the conceptual outcome of the suggested approach, more frequent auctions would need to be implemented. Such frequency of auction will require significant resources and time in implementation and operation. CAISO is still evaluating the alternative approaches and exploring other potential approaches. CAISO will have further discussion with stakeholders. Regarding the comment on outsourcing this effort, CAISO believes it has the elements and expertise with calculating credit requirements for CRRs and, thus, it does not expect at this point to use a third party.

2. EPIC Merchant Energy Comments on CAISO Process to Reevaluate CRR Credit Requirements under Extraordinary Circumstances, March 29, 2009

EPIC Merchant Energy appreciates the opportunity to comment on CAISO's Process to Reevaluate CRR Credit Requirements under Extraordinary Circumstances White Paper issued by the CAISO on March 12, 2009.

Credit requirement calculations should not be an evaluation of expected value but rather an evaluation of risk. The whitepaper states, "The goal of the credit requirement computation is to determine whether a CRR holder has sufficient credit to cover its own *expected negative congestion revenue* from its CRR portfolio." [emphasis added]. The use of the term "expected negative congestion revenue" is inconsistent with the function being performed by the credit requirement calculation. The credit requirement calculation ensures that a CRR holder has sufficient credit to cover its *potential congestion risk* from its CRR portfolio. CAISO uses the term "*potential congestion risk*" in certain parts of the whitepaper and "*expected negative congestion revenue*" in others. EPIC would like the CAISO to use "potential congestion risk" in all parts of the whitepaper for the sake of clarity. This term is more reflective of the risk-matching function being performed by the credit requirement calculation.

The goal of the CAISO credit policy should be to provide security to the CAISO market without unnecessarily limiting competition by creating unreasonable barriers to entry for market participants. This objective is best accomplished by focusing on matching the credit requirement for CRRs with their underlying risk. The credit calculation put forth in the whitepaper unilaterally increases credit requirements without allowing for the appropriate converse. The calculation should match the credit required with both increases and decreases in risk level. The calculation CAISO is proposing is entirely one-sided. The result of this evaluation will be to either raise the credit requirement or to leave it unchanged, without allowing for the possibility of the lowering the credit requirement based on a positive outcome. The new credit requirement calculation does not reflect that abnormal grid conditions could dramatically decrease the potential congestion risk of a

CRR portfolio. EPIC sees the logic in reevaluating CRR portfolios to account for near-term extraordinary events. However, making the result of this evaluation one-sided is overly-conservative and unfair to market participants.

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CAISO RESPONSE: CAISO appreciates the clarification of the language, and will revise the proposal to ensure the consistency of terminology. Regarding the comment that the credit requirement reevaluation will be one-sided, CAISO would like to point out that the reevaluation, just like the calculation of holding credit requirement, is on portfolio basis. Within the portfolio, the credit requirement for some CRRs may increase, but the credit requirement for some other CRRs may decrease. The credit requirement for the portfolio will be the net of that for all the CRRs in the portfolio. What the CAISO is proposing is not to lower the credit requirement for the portfolio. CAISO believes it is appropriate because it will not change the financial positions for those holders whose portfolio credit requirement does not increase in the reevaluation.

3. PG&E Comments on CAISO's Proposed Process to Reevaluate CRR Credit Requirements Under Extraordinary Circumstances

Submitted by	Company	Date Submitted
Derick Stowe (415) 973-5662 Mike White (415) 973-6978	Pacific Gas & Electric	March 27, 2009

Pacific Gas & Electric Company (PG&E) appreciates the opportunity to submit stakeholder comments regarding the CAISO's proposed process to reevaluate CRR credit requirements under extraordinary circumstances. PG&E is supportive of the CAISO's efforts to prepare in advance for extraordinary circumstances. However, while the CAISO's proposal is designed to clarify the procedures in the event of these circumstances, it also generates a number of questions and concerns for PG&E.

First, the CAISO's definition of an extraordinary circumstance in this proposal is unclear. PG&E believes that it is important to provide a more specific definition in order to improve market participants' understanding and implications of this issue. In addition, more information about the CAISO's expectations for the potential size, scope and ramifications would be valuable, and would give us a better understanding of how often these circumstances might occur as well as the potential impact. With the present vague level of definition clarity, PG&E is in turn concerned that the proposal may grant the CAISO unrestricted discretion in its determination of what would

or would not qualify as extraordinary circumstances. Given the possibly of significant financial implications, a more clearly articulated definition would be helpful and would serve to alleviate concerns about how and when the CAISO might deem a circumstance extraordinary.

Second, PG&E requests that the CAISO provide additional details regarding the methodology that would be employed in the event of an extraordinary circumstance. We believe that is important for the CAISO to provide more clarity about the bases, assumptions, inputs, and limitations for the proposed methodologies and calculations. For our internal planning purposes we also request that the CAISO share more details about the design of the proposed simulations.

Third, what is the proposed recourse in the event that PG&E or another market participant disagrees with a CAISO decision? If a policy does not currently exist, we request that the CAISO develop a special recourse policy for extraordinary circumstances.

PG&E looks forward to working with the CAISO staff in further developing and finalizing this issue. For follow-up or questions, please contact Derick Stowe (415-973-5662) or Mike White (415-973-6978).

CAISO RESPONSE: Putting forward a definition of what events can only be classified as extraordinary will unnecessarily limit the scope of the process and leave out any scenario that turns out to be extraordinary and for which reevaluation is still needed. As described in the proposal, the driving factor to consider an event as extraordinary is the specific nature of the event that will be known only until the event per se is known. For this reason CAISO is not defining an explicit list of events. Further, CAISO does not expect that extraordinary circumstances will be a frequent occurrence, although CAISO cannot guarantee that they will be infrequent. Even when extraordinary circumstances do occur, that does not necessarily mean that CAISO will then do a reevaluation of credit requirements -- for example, CAISO will not do a reevaluation if the extraordinary event only affects the Real-Time Market. CAISO is still exploring other potential approaches.

As to the question about what recourse Market Participants have in the event they disagree with CAISO's decision, Tariff Section 12.4.2 contains a process for a Market Participant to dispute a CAISO request for additional Financial Security. These same tariff provisions would apply to any CAISO requests for additional Financial Security due to extraordinary circumstances.

4. SCE’s Stakeholder Comments: Process to Reevaluate CRR Credit Requirements under Extraordinary Circumstances

Submitted by	Company	Date Submitted
Edwin Tso (626) 302-9712 Michael Kramek (626) 302-7455	Southern California Edison	March 30, 2009

In accordance with the California Independent System Operator’s (“CAISO’s”) request at its Process to Reevaluate Congestion Revenue Rights (“CRRs”) Credit Requirements stakeholder conference call held March 20, 2009, Southern California Edison Company (“SCE”) hereby submits its comments on the draft Process to Reevaluate CRR Credit Requirements Under Extraordinary Circumstances (“CRR Credit Requirement Process Under Extraordinary Circumstances”) issued by the CAISO, dated March 12, 2009.

SCE appreciates the opportunity to comment on the draft CRR Credit Requirement Process Under Extraordinary Circumstances. SCE also appreciates the efforts of the CAISO to improve the CRR Credit Requirements process for events such as extended transmission outage or other abnormal grid conditions, which could cause dramatic increase (or decrease) with the payment obligations for CRRs. Pursuant to the section, Holding Credit Requirements under Normal Conditions¹, the CAISO proposes to calculate CRR credit requirements using the monthly auction value for CRRs that were obtained in the monthly allocation or auction process and for all other CRRs (seasonal), to use the non-monthly auction price. SCE believes that this proposal conflicts with the CAISO Tariffs sections 12.6.3.1 (c) and 12.6.3.2. Section 12.6.3.1 (c) gives the CAISO the authority for CRR’s with terms of one year or less to account for changes in the monthly auction prices for such CRRs when re-evaluating the credit requirement to hold the CRR until maturity. Tariff section 12.6.3.2 more directly states that CRRs with terms of one year or less shall be subject to a credit holding requirement equal to the most recent CRR auction price. Pursuant to the CAISO Tariffs, SCE believes that the CAISO should update its seasonal CRR credit holding requirements to correspond with the monthly auction prices. Therefore, SCE requests the CAISO to clarify in the above referenced white paper and the CRR BPM, that the CRR credit holding requirements will be updated utilizing its monthly auction value. Moreover, SCE requests the CAISO to provide additional details on how the credit holding requirements are updated for seasonal CRRs with its monthly auction prices. Understanding the CAISO process for recalculating seasonal CRRs credit holding requirements using monthly auction prices is critical for SCE to manage its collateral position with the CAISO.

¹ CAISO’s Process to Reevaluate CRR Credit Requirements under Extraordinary Circumstances, Page 5

CAISO RESPONSE: CAISO appreciates this opportunity to clarify the use of auction prices within the CRR credit evaluation process. In the proposal paper, CAISO incorrectly stated that prices from monthly auctions are used only for monthly CRRs. Indeed the CAISO is adhering to the tariff by using the most recent auction prices. Every time a new set of prices is available from the most recent CRR auction, either seasonal or monthly, such prices are applied to the corresponding CRRs of the relevant month. For instance, if prices of the monthly auction of August are now available, these prices will be then used for all CRRs valid in August. The prices of September, however, will still use the prices of the most recent seasonal auction. Then in the next month when the auction prices for September become available, they will be used for any CRRs valid in September and so on.

5. WPTF comments.

WPTF appreciates the opportunity to provide input on the CAISO's process to reevaluate credit requirements. WPTF offers the following comments.

- WPTF is very supportive of the CAISO's intention to ensure sufficient collateral exists to protect market participants from defaults.
- The CAISO should have a clearer description of the model they will use to come up with the expected values of the CRRs under extraordinary conditions. While WPTF is supportive the concept generally, the CAISO's current proposal suggests that the methods may be overly complex, difficult for the CAISO to implement, and difficult for SCs to mirror for estimation purposes.
- The CAISO's processes, including the types information used to arrive upon collateral values under normal and extraordinary conditions, should be very transparent and known to all market participants. WPTF does not believe that the CAISO's treatment of extraordinary collateral requirements should lead to a reduction in transparency.

WPTF encourages more discussion on this issue and the CAISO's further creative thinking on how to make the collateral determinations feasible and transparent.

Please contact me if you have any questions or would like further input.

CAISO RESPONSE: The process used to compute the credit requirements are fully described in the CRR BPM. The process to reevaluate credit requirement under extraordinary circumstances is built upon the same process, with the additions described in the proposal. Once an extraordinary event requires the reevaluation of credit requirements, CAISO will make available not only the methodology used for the revaluation, but also the explanation for which a specific event is treated as extraordinary and its details. CAISO is still evaluating potential approaches for further discussion with stakeholders.