Appendix B

ISO Approved Security Agreements

Supplemental Information

#### Alternatives Considered:

Current CAISO practice: The CAISO has published recommended pre-approved forms of letter of credit (LOC), escrow agreement and guaranty agreements, but allows Market Participants (MPs) to submit their own forms, which the CAISO reviews for acceptibility. As a result of the CAISO’s current practice, the CAISO has accepted a variety of security instruments forms, many of which are subject to the laws of (and must be enforced in) other states. In addition, certain of the instruments vary from the approved forms in ways that could impose additional costs on the CAISO if there was a need to enforce them.

Alternate (recommended) approach: The CAISO may require use of pre-approved forms for certain types of security, e.g. guaranty and escrow agreement, but accept use of industry-standard forms for other types of security such as bank-issued LOCs and consider unique forms on a case-by-case basis.

#### Practices at other ISOs:

**PJM** requires market MPs to provide security “in a PJM approved form and amount” including cash and LOCs per the following guidelines including:

Cash Deposit held by PJM

LOC from US-based institution (or foreign with US branch) that have minimum corporate rating of “A” by S&P or Fitch or “A2” from Moody’s. PJM will consider the lowest rating. The LOC must specify successive one-year periods, until terminated on 90-days notice from the financial institution. The LOC must clearly state the full names “of “Issuer”, “Account Party” and “Beneficiary”, the dollar amount available for drawings and state that the funds will be dispersed upon presentation of the drawing certificate . . . .”. PJM has an approved form of LOC. If the LOC varies in any way, it must first be reviewed and approved by PJM.

Other Forms of Security—PJM requires MPs to execute a “Credit Agreement” indicating they understand and agree to comply with PJM’s credit policies. PJM also requires MPs to submit “Compliance Certificates” (initially and, apparently, on an annual basis) indicating compliance. PJM also has an approved form of guaranty.

**NYISO** accepts collateral in the following forms:

Cash deposit held by the NYISO.

LOC in form acceptable to the NYISO by an approved US or Canadian commercial bank with minimum “A” rating from S&P, Fitch, Moody’s or Dominion. Failure to provide alternative source of credit 50 days prior to termination of LOC, which source shall remain in effect for not less than one year, is a condition of default.

Guaranty in form acceptable to NYISO from investment grade U.S. or Canadian affiliate. Failure to provide alternative source of credit 50 days prior to termination of guaranty, which source shall remain in effect for not less than one year, is a condition of default.

Surety Bond in form acceptable to NYISO payable immediately upon demand without prior demonstration of validity of demand issued by U.S. Treasury-listed surety with minimum “A” rating from A.M. Best. Failure to provide alternative source of credit 50 days prior to termination of surety bond, which source shall remain in effect for not less than one year, is a condition of default.

NYISO allows netting of amounts receivable upon written notice to the NYISO.

Pay-down Agreement is allowed whereby MP agrees to pay upon demand amount by which its “Operating Requirement” (amount required to be secured) exceeds its total amount of credit plus collateral.

Substantially similar alternative security arrangements allowed in “exigent circumstances” on approval.

Prepayment Agreement, form agreement included in tariff.

**NEISO/NEPOOL** accepts the following forms of security:

Cash Deposit, which is invested in direct obligations of the United States with interest paid to the MP, provided the MP also executes a Security Agreement in the form as provided in the tariff.

LOC in an acceptable form (sample form included in tariff) from bank with minimum corporate debt rating of A- (S&P), A3 (Moody’s), A- (Duff & Phelps) or A- (Fitch), or equivalent short-term debt rating by same, from a U.S. bank or foreign bank with US branch. ISONE will check quarterly to ensure compliance. ISONE provides a “generally acceptable” sample LOC and requires all LOCs to be in this form with only minor nonmaterial changes, unless variation is approved by Budget and Finance Subcommittee.

Payment bond in acceptable form, which must include a provision permitting suit until two years after the date MP’s obligations cease. The insurance company issuing bond must be rated A or better by A.M. Best & Co.

Guaranty from MP’s affiliate may be acceptable. If guarantor is not itself a MP, the amount is capped (Guaranty Limit), which is monitored on a daily basis. Non-MP Guarantor is required to submit substantial financial information on a regular basis. Non-Foreign (U.S. and Canada) guarantors are acceptable if no defaults within prior 6 months, guarantor meets financial condition requirements; allows for direct recovery of obligation from guarantor; and form and substance is acceptable. Foreign guarantors have additional requirements. Tariff provides that guaranties are considered to be lesser forms of financial assurance than cash, LOCs or payment bonds. Guaranty must be duly authorized by guarantor and signed by officer and guaranty must be “furnished with either an opinion satisfactory to the System Operator of the Guarantor’s counsel with respect to the enforceability of the Corporate Guaranty or accompanied by a certificate of corporate guarantee that includes a seal of the corporation with the signature of the corporate secretary” along with documentation of the signature authority. The form of guaranty is specified in the tariff and only minor non-substantive changes allowed unless approved by Budget and Finance Subcommittee.

NEISO allows security to be reduced or “setoff” by the amount NEPOOL or NEISO may be obligated to pay.

#### Assessment of Alternatives:

Criteria used to assess the alternatives include:

1. Administrative ease and cost burden on CAISO;
2. Cost burden on MP;
3. Mitigation of risk (of ultimate collectibility) and
4. Whether change requires Tariff amendment.

## 

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Option | Administrative ease and cost | Impact on MP | Mitigation of Risk | Tariff Amendment |
| 1. Require use of CAISO legal forms | Once approved forms in place, minimal burden/cost on CAISO | MP may not be able to use preferred form of security and would be subject to California law/venue | High | Probably, although current tariff allows for CAISO discretion |
| 2. Current Practice | Hard and high--Treasury, legal and client relations departments should be involved in negotiation and review of each instrument and many forms of security are subject to laws of states other than California | This is the most MP friendly option as CAISO has allowed MPs to submit their own forms, though CAISO could be more demanding than it has been | Medium—if CAISO unable to ensure all instruments receive adequate review prior to acceptance | No |
| 3. Hybrid Approach | Medium—use of CAISO legal forms and industry standard forms should limit CAISO attention to smaller number of unique instruments | MPs will have fewer options than today, but will have more choices than under option 1 | High, if CAISO legal forms in place for certain types of security and industry standard forms used for others | Probably, although current tariff allows for CAISO discretion |