Stakeholder Comments Template

Subject: Credit Policy Enhancements

Submitted by	Company	Date Submitted
Jack Lewis *858 654-6433*	*SDG&E*	*October 7, 2008*

This template has been created for submission of stakeholder comments on the topics covered in the September 22, 2008 Credit Policy Enhancements stakeholder meeting. 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 October 7, 2008 or sooner.

Please submit your comments to the following questions for each topic in the spaces indicated.

1. Do you support CAISO's proposal (Alternative 3) to replace the use of Credit Rating Default Probabilities and Moody's KMV Default Probabilities with the use of agency issuer ratings and Moody's KMV Spot Credit Rating in its eight-step process credit assessment process? Do you agree that these ratings should be blended according to the same percentages already established in the eight-step process? Do you agree that Moody's KMV Spot Credit Rating should be used, according to the same blending percentages, to assess whether a financial institution meets CAISO's "reasonably acceptable" test for accepting a Letter of Credit or an Escrow Account (i.e., the blending must yield a result greater than or equal to four (4.00) to be "reasonably acceptable"?)

   Yes, SDG&E supports the Alternative 3 proposal that replaces the Credit Rating Default Probabilities and Moody's KMV Default Probabilities with the use of agency issuer ratings and Moody's KMV Spot Credit Ratings in the eight step credit assessment process. Alternative 3 reduces the maximum unsecured credit limits to an amount lower than $100 million based on stakeholder consensus which is consistent with our perspective to control and limit overall risks to participants. Also, we support examining whether this limit can be further reduced when payment acceleration arrives. The rationale of eliminating unnecessary conversion of ratings to default probabilities and the simplification of the process appears sound. Additionally, it provides greater flexibility in allowing the use of Fitch and DBRS and any other ratings that can be mapped to Moody's or S&P. It would still use multiple sources (agency ratings) and Moody's KMV Category Spot ratings in establishing the percent of Tangible New Worth or Net Assets to apply.

This permits flexibility and the use of multiple sources. The Moody's KMV spot credit rating is viewed as a leading indicator of rapid deterioration of a market participant's financial condition which is beneficial advantage in the market environment that we find ourselves. SDG&E also believes a 50% weighting is an appropriate factor.

2. Do you support CAISO's proposal to expand the definition of Tangible Net Worth to exclude assets that are earmarked for a specific purpose such as restricted assets and assets related to affiliated entities? Do you also agree that CAISO should also exclude highly volatile assets such as derivative assets?

   Yes, SDG&E does support limited expansion of the definition of Tangible Net Worth. Although, the current formula (assets minus intangibles) minus liabilities is straightforward and can be easily and uniformly applied, excluding certain classes of assets may be more difficult to assess and would require significantly more monitoring as these account balances change each month. How would CAISO determine what the balances are at a point in time since they fluctuate thru the month as does the entities credit status with CAISO?

   Yes, SDG&E does agree that highly volatile assets such as derivative assets should be excluded as their values cannot be relied upon and are difficult to assess on an ongoing basis.

3. Do you support CAISO's proposal (Alternative 2) to reduce the maximum amount of unsecured credit that it will assign to the most creditworthy party to $100 million?

   Yes, SDG&E does support CAISO's proposal Alternative 2 to reduce the maximum amount of unsecured credit to $100 million. Reduction of exposure appears warranted given the environment that we are in and is a warranted response to it.

4. Do you support CAISO's proposal (Alternative 2) to allow Guarantees and other forms of Financial Security to be issued from Canadian entities? Do you support expanding this policy to accept Financial Security from non-US / non-Canadian based entities using rules similar to those adopted by ISO New England if CAISO can clear the legal hurdles and complexities of developing the necessary processes and agreement language for accepting Financial Security from foreign entities? Are ISO-NE's restrictions sufficient and necessary? Should other safeguards be put in place? Should CAISO consider extending this policy to other types of Financial Security such as Letters of Credit?

   Yes, if the same level of credit criteria and credit analysis screening and monitoring can be done for Canadian entities that are being done for current domestic participants then SDG&E would support this. However, SDG&E would want to be comfortable that if there are cross border defaults that there would not be significant additional legal impediments to making CAISO/other participants whole.

SDG&E does not support expanding it to non-Canadian and non-US foreign entities. The benefits of such an expansion appear to not outweigh the additional complexity created and potential incremental exposures. It raises a new set of issues such as legal, foreign exchange and perhaps accounting that complicates our immediate goals.

5. Do you agree that an Affiliate Guaranty, where a Guarantor backing the obligations of one Affiliate must provide the same Guaranty for all of its Affiliates in the CAISO market, is essential to help mitigate the risk of a payment default by an under-secured and thinly capitalized Affiliate? Does the concept presented present regulatory issues for non-regulated parents backing regulated and non-regulated affiliates?

No. SDG&E does not agree. This proposal brings up insurmountable regulatory issues and it does not make sense in today's regulatory environment. It is particularly problematic for Regulated Utilities and does present significant credit exposure issues for non-regulated parents who may then be backing regulated affiliates exposures. Due to peripheral regulatory and parent credit issues that would be created, SDG&E is not supportive of this proposal. The proposed change would require the parent to have a guaranty limit sufficient to cover the total estimated liabilities of all of their affiliates regardless of individual credit limits that they may want to assign. The proposal also gives CAISO authority to reallocate individual affiliate credit limits, up to the guaranty limit to cover calls to individual affiliates for additional collateral. This proposal raises many needless regulatory or affiliate issues. These goals can be accomplished with strong credit policies instead of needlessly complicating various parent-affiliate relationships.

6. Do you support CAISO's proposal (Alternative 1) to reduce the time to post additional Financial Security from five (5) Business Days to three (3) Business Days?

Yes, we would support the reduced time to post additional Financial Security. As indicated, a reduction in time reduces the exposure of a market participant exceeding their total credit limit and appears warranted in the current environment.

7. Should CAISO change its policy allowing 100% of Market Participant's available credit (i.e., Aggregate Credit Limit minus Estimated Aggregate Liability) to be

available for a Congestion Revenue Rights ("CRR") auction? Is setting the amount of available credit at 90% of available credit a reasonable approach to ensure some buffer remains in place for a Market Participant's other market activities? Should a lower threshold be considered?

Yes - SDG&E believes that setting the amount at less than 100% is helpful to reduce overall risks to all market participants. Lower thresholds should be considered for lower credit rated entities. The problems cited with the introduction of convergence bidding warrant consideration of a lower threshold.

8. Are you in favor of the CAISO funding a reserve account as a means of providing a source of funds in the case of a payment default? How would you propose that such an account be funded?

No, SDG&E is not in favor of funding a reserve for payment defaults. This would tie up additional resources and may not specifically address the credit risks of one particular market participant. Additionally, the implementation and administrative issues would be significant.

9. Are there other payment default risk mitigation strategies, of those that were presented, that you support and would want CAISO to investigate further such as a Line of Credit, credit insurance, establishing a captive insurance company, developing a blended finite risk program or a capital market transfer to provide potential funding sources in the case of payment default? Are there other strategies that were not covered that CAISO should investigate and/or pursue?

SDG&E does not support any of the above as a blanket application to all market participants. We would support payment default risk mitigation measures being applied only to those participants who's credit assessment results in a higher than average credit risk to CAISO. This approach is consistent with a market approach that more preventive and mitigation measures are required of lesser credit quality entities/participants.

10. Do you support CAISO changing its loss sharing/chargeback mechanism to include the allocation of a payment default to all Market Participants – not just net creditors during the default month? What measure should be used to apportion exposure to the chargeback?

No. Currently net creditors absorb all the risk of a default. A change may result in adverse incentives to reduce exposure by individual market participants.

11. Do you agree with CAISO's proposal to assess financial penalties on Market Participants who are late in paying their invoices two or more times in a rolling 12 month period? Are the financial penalties sufficient to ensure compliance with the payment provisions of the CAISO Tariff? Do you agree that Market Participants who are late a third time in a rolling 12 month period should also have to post cash in lieu of any unsecured credit for a period of 12 months of on-time payments? Do you agree that any penalties collected should fund a reserve account that can be used as a source of funds in the case of a payment default?

Yes, but we would want to assess how much they would be. The implementation features of assessing financial penalties would need to be fully assessed. What occurs if the penalties are not promptly paid? Requiring cash appears to be a better solution for parties who are late than using unsecured credit. Cash collateral effectively limits the credit risk. Using unsecured credit does not mitigate the credit risks -- it just transfers it to another unsecured source.

12. Do you agree with CAISO's proposal to assess a financial penalty on a Market Participant who is late in posting additional collateral on the third and each subsequent time in a rolling 12 month period? Are the financial penalties sufficient to ensure compliance with the collateral posting provisions of the CAISO Tariff? Do you agree that any penalties collected should fund a reserve account that can be used as a source of funds in the case of a payment default?

Yes, but we would want to assess the magnitude of penalties and the potential ramifications. The penalties alone may not ensure sufficient compliance and therefore there would likely need to be other measures. We agree that penalties imposed should be used to fund a reserve account. Late payments may signify that a participant is having credit related issues and exhibiting greater risk. Consequently, penalties appear warranted to reflect the greater risks being incurred.

13. Do you support the creation of a Credit Working Group ("CWG") as a means to formalize the CAISO's approach to managing credit policy change? How do you envision the CWG adding value to CAISO's existing stakeholder process (e.g., regularity of meetings, membership, etc.)?

We support the creation of a Credit Working Group as an approach to manage credit policy changes. We envision the CWG adding value by regular discussions on emerging issues such as the credit environment that we are currently in. The group could develop emerging issues topics and set the table for potential policy improvements.