Strategic Energy's Comments on the CAISO's Proposed Credit Policy Changes, April 2005

Strategic Energy appreciates the opportunity to provide comments on the CAISO's proposed changes to its credit policy. Strategic has reviewed the CAISO's latest discussion papers and participated in the 04/26/05 conference call. Strategic respectfully offers the following comments.

Setting Credit Limits (Section 4.1)

Strategic requests that the CAISO provide training and an explanation of Moody's KMV model to all SCs before implementing this change. Most SCs probably have no familiarity with this model, yet are being asked to agree with its use in setting the SC's Unsecured Credit Limit.

Response:
As part of the commitment to transparency in the process we intend to implement, we recognize the value of this, and will take steps to ensure that SCs understand what is being done. Moody's KMV does have some published material on their approach that should explain the basis for their EDF measures:

http://www.moodyskmv.com/products/RiskCalc_private.html
http://www.moodyskmv.com/products/edf_rc31_usa.pdf

One of the benefits of the proposed approach is that it will be repeatable and objective, i.e. the ISO and the SC should arrive at the same determination of the credit limit based on same data.

Approved Security Agreements (Section 4.3)

Strategic would like the opportunity to review the CAISO's standard-form documents for the Guaranty and the Letter of Credit before they are adopted.

Response:
We agree this would be a good step, and will do so. Our goal is to have standard forms that strike a reasonable balance between the needs of the ISO and participants, and which can be quickly used with a minimum of administrative effort on either side.

Credit Insurance (Section 4.5)

We continue to think this is an interesting idea and would like to see more information on how this insurance could be provided at a reasonable cost. As the discussions with Aon progress, we would like to receive updates from the CAISO on this topic.

Response:
CAISO is working with an insurance broker as of May 2005, and have received a proposal from one insurer during May. We will receive proposals from at least one other insurer, and negotiate for as favorable of terms and coverage cost as possible. We will keep market participants informed of our progress.

Costs appear to be somewhat higher than we had anticipated, apparently due to the increased turmoil in the bond markets and higher credit risk premiums given the GM, Ford downgrades, and other events such as the United Airlines pension fund issues.

<u>Number of Days Included in Liability Calculation (Section 5.5)</u>

The proposal for a "Level posting period" of 102 days is excessive and burdensome, especially when compared to the requirements of other ISOs. Strategic urges the CAISO to make it a high priority to reduce this requirement as soon as possible. Strategic is concerned that the CAISO's Payment Acceleration Project continues to slip and is now scheduled to be implemented in mid-2006.

Response:
CAISO recognizes the need to substantially reduce the length of the payment cycle and is committed to doing so. We have, and continue to view this as a high priority project. It is scheduled for implementation as soon as possible in 2006 upon the completion of the new Settlements and Market Clearing system, which is a requirement for payment acceleration.

As for the level posting requirement, nearly all SCs are posting to that requirement today—there are just a few who have posted on a weekly basis in recognition of the fluctuating number of days outstanding. We allowed for that flexible approach on a "pilot program" basis in 2003. We believe that given the move to substantially reduce the length of the payment cycle (albeit in 2006), it make senses to return to posting requirement that matches the somewhat longer-term positions of each SC (maximum outstanding over the course of the payment cycle). The weekly approach will be permitted to continue in some circumstances, such as for new SCs until they have transacted for the number of days in the payment cycle.

The number of days in the level posting period will drop when Payment Acceleration is implemented.

<u>General Question</u>

Under the CAISO's proposed rules, could Strategic receive an open line and then reserve the right to post either a Guaranty or a Letter of Credit to cover the exposures?

Response:

Yes. SCs may choose to post more than one form of security, if such postings are required (for SCs that owe funds, and would not have a sufficient unsecured credit limit). An SC could choose to post collateral even if it had unsecured credit capacity with the ISO. An SC could also choose not to apply for unsecured credit, and instead post collateral.

Strategic Energy
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