Southwest Power Pool

Memorandum

To: **SPP Finance Committee**

From: **Thomas P. Dunn**

CC:

Date: **November 14, 2011**

Re: **Summary of CPWG/FC Call November 9, 2011**

The SPP Finance Committee and the SPP Credit Practices Working Group ("CPWG") held a joint teleconference meeting on November 9, 2011 to review the recommendation of the Credit Practices Working Group on the use of Day-Ahead market data to determine potential exposure to Day-Ahead market customers. The course of the discussion also touched on SPP's credit methodology, the operating environment in the SPP region, changes in credit administration expected once the Integrated Marketplace is implemented, potential exposure calculations for Virtual transactions and Transmission Congestion Rights ("TCR") positions.

The SPP region differs from the other RTO/ISO regions by virtue of not having any retail open access. This difference is important in that it limits participants in the SPP Day-Ahead market to only those entities recognized as electric utilities. Additionally, the utilities in the SPP region are generally integrated utilities meaning the utility serves load and also possesses generation. Integration serves to help reduce the potential for a participant in the Day-Ahead market to be fully exposed to real-time prices.

SPP's administration of credit will remain fairly consistent with its existing practices. In summary, the credit administration process follows the following steps:

1. Customer registers for service with SPP
2. SPP performs a credit analysis on the customer
    a. Reviews both qualitative and quantitative aspects to determine credit score
    b. Credit score determines level of unsecured credit the customer is eligible to utilize
    c. Analysis update frequency dependent on amount of unsecured credit granted and credit score
3. SPP determines Total Potential Exposure of customer (initial based on expectations; ongoing based on calculation)
4. Total Potential Exposure compared to unsecured credit limit determines amount of Financial Security required (TCR exposure will always be secured)
5. Total Credit Limit established which is sum of Financial Security and unsecured credit limit
6. Potential Exposure continuously compared to Total Credit Limit.
    a. When Total Potential Exposure equals or exceeds 90% of Total Credit Limit, system creates a flag alerting SPP Credit Dept. Customer is contacted and advised of status
    b. When Total Potential Exposure equals 100% of Total Credit Limit:
        i. Virtual bids/offers will not be accepted by system
        ii. New TCR positions creating exposure will not be accepted by system
    c. When Total Potential Exposure exceeds 100% of Total Credit Limit:
        i. Customer notified of potential default,
        ii. Request made for additional Financial Security and/or early payment of outstanding invoices

iii. Must cure potential default within two business days

7. Default occurs when cure period expires without being cured. No ability to transact in Virtual and TCR markets. Filing at FERC to terminate transmission service agreements and activity in Day-Ahead and Real Time markets

Potential Exposure is an estimate of how much customer may owe SPP before SPP can terminate service. The calculation varies depending on specific product, however, calculation based on three distinct subsets: i) amounts invoiced but not paid; ii) amounts settled but not invoiced; iii) amounts estimated but not settled. The first two subsets are amounts that are known by SPP and by the customer. The third amount, estimated but not settled, is an estimate of the exposure expected to accrue based on prior activity and market pricing/volatility. The calculation of estimated but not settled is summarized below by new product type:

Virtual: MWs bid or offered multiplied by the 97th percentile worst outcome experience during the same quarter of the previous year.

TCR: MWs multiplied by reference price. The reference price is the weighted two year mean price minus a stress test price. Stress test price for positive TCR mean is 75th percentile and for negative (counterflow) TCR mean is 90th percentile.

Day-Ahead Greater of the average daily settlement over past 365 days or the average daily settlement (or pre-settlement OD+4 data) over the past 7 days multiplied by the number of days through cure period

The CPWG recommends calculation of Day-Ahead exposure for the 7 day average by averaging the most recent pre-settlement runs generated 4 days after each operating day (OD+4), without validation along with the remainder of the 7 days being initial settlement statements generated 7 days after each operating day (OD+7)The accuracy of the OD+4 settlements is very close to that of the initial settlement statement (see memo attached). The CPWG was not compelled that using a settlement run one day after the operating day provided meaningful information to the level of exposure due to only have 4 of the 20 day-ahead charges available (calculation would not have real-time meter data or complete bilateral settlement schedules).