



Date: October 29, 2002
To: SUIS Members and Interested Parties
From: Bill Newbold (SUIS Co-Chair)
Subject: **Materials to Review for November 8, 2002 SUIS Meeting**

Enclosed is a document containing the first draft "Strawman" documents for each of the Creditworthiness assignments made at the September 18 SUIS meeting.

Please review these for content only, not for formatting or wordsmith. Most important, did we miss important concepts? Do we have concepts that shouldn't be included? Are some of our concepts wrong or totally unacceptable?

All of these need considerable work, but I'd be happy if we can get basic agreement as to much of the desired content at the November 8 meeting, so that we can charge the sub-teams to further develop the concepts into standards.

Please e-mail your comments back to me before next Monday (Nov 4). My e-mail is newboldw@detroitedison.com. I will distribute them to the sub-teams and we hope to incorporate them in the November 8 meeting. Your e-mails will give us a head start on the meeting.

The purpose of the November 8 meeting will be to review these drafts in hopes of closing in on the key concepts that need to be in potential Creditworthiness standards and to plan our next steps to turn these concepts into workable standards.

A Draft Agenda should be out shortly.

Thanks for your help.

Bill

Draft Creditworthiness Standards ***Overall***

Principles

- The credit risks of one Market Participant (Retail Supplier or Distribution Company, for example) should not be shifted from one party to another without agreement, appropriate compensation, or both.
- Procedures for one Market Participant to establish creditworthiness with another should be published so that applicants know the requirements prior to applying for credit.
- Evaluation of creditworthiness and granting of credit should be performed in a non-discriminatory way.
- Creditworthiness procedures should be applied equally to regulated and unregulated Market Participants
- Creditworthiness procedures should be efficient to minimize the time and effort required by the parties to start/maintain a working relationship.
- Creditworthiness procedures for implementing retail access should be consistent with standard commercial practices whenever possible.

Standards

Scope:

The procedures/processes described in these Standards apply to credit risks existing between a Retail Supplier and a Distribution Company in the course of serving Retail Access customers, including:

- Risks associated with one party doing the billing and receiving payments for the other party when billing is consolidated
- Risks associated with the Retail Supplier's direct purchase of distribution services on behalf of their customers under the Single Retailer Model
- Risks associated with being the Default Provider of provider of last resort who provides replacement power when a supplier defaults
- Risks associated with receiving payment for other services one Market Participant provides another.

Certain other risks that might involve a Retail Supplier or a Distribution Company are excluded, since they represent wholesale transactions, such as:

- Provision of transmission-related ancillary services by a Distribution Company in the absence of those services being provided by an RTO or Transmission Provider
- Imbalance/settlement risk between a Retail Supplier and a Distribution Company, where the Distribution Company is the effective provider of imbalance service.

Also excluded are Consumer risks associated with Suppliers failing or otherwise withdrawing from the market.

Draft Creditworthiness Standards
Creditworthiness Evaluation Process

- **Initial Credit Evaluation** (within 30 days of receipt of documents)
 - Billing party provides two years audited financial statements
 - Two most recent Annual Reports.
 - Most recent SEC Form 10-K and 10-Q; or if SEC Form 10-K is unavailable, substitute with audited annual financial information (including a balance sheet, income statement, and cash flow statement).
 - Most recent quarterly or monthly financial information (including a balance sheet, income statement, and cash flow statement) accompanied by an attestation by Applicant's Chief Financial Officer that the information submitted is true, correct and a fair representation of Applicant's financial condition.
 - P - The Non-billing party must perform its credit evaluation and associated security calculation in a non-discriminatory manner.**
 - P – The evaluation process and methodology must be approved by the Applicable Regulatory Authority and clearly stated in the appropriate Governing Document.**
 - Non-billing party evaluates the Billing Party's level of creditworthiness (unsecured)
 - Bond rating
 - Evaluation of financial statements
 - P – The Non-billing party must be prepared to provide the rationale for its determination of the Billing party's level of unsecured creditworthiness.**
 - Non-billing party will determine risk exposure associated with the Billing party
 - Billing options
 - Number of customers non-billing party plans to serve
 - Customer class that the non-billing party plans to serve
 - P – The Non-billing party must be prepared to provide the rationale for its determination of the risk exposure associated with the Billing party.**
 - Non-billing party will determine the level of security needed to cover the difference between the Billing party's creditworthiness and the level of risk exposure associated with the Billing party
 - Billing party can satisfy the Non-billing party's security requirement by providing any of the following security vehicles:
 - ???
-
- **Reevaluation of Creditworthiness** On-going/As needed

- Billing party, or guarantor, if applicable, shall promptly notify the Non-billing party of any material change in its credit rating or financial condition.
- Non-billing party may initiate the re-evaluation of a Billing party's creditworthiness whenever it becomes aware of an adverse change in the Billing party or Guarantor's financial standing.
- Billing party will provided the Non-billing party with audited financial statements as needed to reevaluate the Billing party's creditworthiness
- Non-billing party evaluates the Billing party's level of creditworthiness (unsecured)
 - Bond rating
 - Evaluation of financial statements.

P – The Non-billing party must be prepared to provide the rationale for its determination of the Billing party's level of unsecured creditworthiness.

- Non-billing party will determine risk exposure associated with the Billing party.
 - Billing options.
 - Number of customers the Non-billing party plans to serve.
 - Customer class that the Non-billing party plans to serve.

P – The Non-billing party must be prepared to provide the rationale for its determination of the risk exposure associated with the Billing party.

- Non-billing party will determine the level of security needed to cover the difference between the Billing party's creditworthiness and the level of risk exposure associated with the Billing party.
- Billing party can satisfy any additional security requirement by providing any of the following security vehicles:
 - ???
- Should the Non-billing party's re-evaluation determine that the security requirement has been reduced, the Non-billing party will notify the Billing party, and take whatever action the Billing party requests to return the surplus.

Draft Creditworthiness Standards
Process to Challenge Credit Determination
(Reconsideration/Challenge)

Principles

- An Applicant must be granted an opportunity to challenge an unfavorable determination by the Creditor
- A Creditor must provide a complete explanation of its evaluation process upon request by an Applicant
- The frequency of challenging creditworthiness determinations or requesting reconsideration must be limited to avoid overburdening the parties.
- Creditworthiness re-evaluations must be performed promptly.
- Either party must have the ability to request a reevaluation of creditworthiness when the Applicant's credit situation changes significantly.
- The procedures and criteria used to perform a re-evaluation of creditworthiness should be the same as used for the initial determination.
- The applicant must notify the Creditor promptly of any material adverse change in its credit rating or financial condition.
- When the Creditor is the Distribution Company (or similar regulated entity), there should be an expedited process for the Applicant to bring their challenge of a creditworthiness determination before the applicable regulatory body.

Definitions

- **“Challenge”**: The Applicant's request for a review of the Creditor's creditworthiness determination made shortly after that determination.
- **“Event-driven Reconsideration”**: A re-evaluation of an Applicant's creditworthiness performed in response to a material change in their credit rating or financial condition.
- **“Periodic Reconsideration”**: A routine review of an Applicant's creditworthiness.
- **“Reconsideration”**: A periodic or event-driven reevaluation of an Applicant's creditworthiness.

Standards

- An Applicant may submit a Challenge to the outcome of the Creditor's evaluation process within 30 days of being notified of that outcome.
 - The Creditor must respond to such a timely challenge by providing the rationale for its determinations and the calculations supporting the resulting credit limit. The Creditor must also review the data used as inputs with the Applicant to ensure there were no errors or missing data that impacted the result. If there were material errors or omissions the Creditor must re-evaluate the applicant's creditworthiness within 30 days of the completion of the review.
 - If the Applicant remains dissatisfied with the outcome of the creditworthiness evaluation by a creditor who is regulated, it may elevate its Challenge to the Appropriate Regulatory Authority.
- An Applicant must notify the Creditor of any material adverse change in its financial condition within 30 days of such change occurring.
- A Creditor may re-evaluate the creditworthiness of an applicant whenever it becomes aware of a material adverse change in the Applicant's financial condition
- An Applicant may request an Event-Driven Reconsideration when there has been a material favorable change in their financial status, such as an upgrading by a major bond rating agency
- An Applicant may request a periodic re-evaluation of their creditworthiness no more than once every twelve months

Draft Creditworthiness Standards
Process for Disqualifying Party Who Doesn't Provide Security in a Timely Manner

Issue: Process for disqualifying suppliers who do not provide security in a timely manner

I believe a good starting point in addressing this issue is the UBP manual, page 58 (Section VII. E. 2. – see below). Instead of “reinventing the wheel”, perhaps we can build upon or edit this text as needed. The highlighted portion below specifically addresses a scenario under which a Supplier may be disqualified. My interpretation of this issue is that we're talking about disqualifying the Supplier from a specific Utility's service area...not disqualifying the Supplier from an entire state.

Change in Credit Standing: The Utility may re-evaluate the creditworthiness of Supplier whenever it becomes aware of an adverse change in the Supplier or Guarantor's credit standing. As long as the Supplier continues to meet the Utility's minimum standard for unsecured credit, no action will be taken. When an adverse change in a Supplier's credit standing causes the Supplier to no longer qualify for unsecured credit from the Utility, the Utility has the right to require security, prepayment, or a deposit as specified herein. If the required security or deposit is not tendered within twenty (20) calendar days of the Utility's request, the Utility may begin taking actions to reduce its exposure, including:

- a. Cease processing any Switch Requests that add to the Customers served by the Supplier;
- b. Moving any of the Supplier's Customers currently on Supplier Consolidated Billing to Dual Billing, effective on the Customer's next normally scheduled bill; and/or
- c. Discounting the sales of any other products or services the Utility may have been selling to the Supplier.

If the required security or deposit is not tendered within forty-five (45) days of the Utility's request, the Utility may initiate a proceeding with the appropriate regulatory authority to disqualify the Supplier from serving customers in the Utility's service area. Upon such disqualification, the Supplier's Customers will be returned to Default Service at their next (normally scheduled) bill. The Supplier remains responsible for these Customers' energy usage until the effective date of their return to Default Service. If a Supplier can partially, but not fully, meet such a security or deposit in this time period, they can avoid disqualification by reducing the level of exposure they present to the Utility to an amount commensurate with the amount of security or deposit tendered.

Draft Creditworthiness Standards
Calculation of Credit Exposure and Determination of Credit Limits

1. Applicability

- To the Supplier when the Supplier is offering Consolidated Billing
- To the Utility when the Utility voluntarily offers Consolidated Billing
- To one Party when the other Party is the Provider of Default Generation Service (DGS) and/or Provider of Last Resort Service (PLR) in a Customer Choice environment

2. Calculation of Credit Exposure

The credit exposure should be based on the dollar amount determined to be at risk and the period of time during which it remains at risk. These two components could be determined only when some the following issues are known:

- The definition of the process (Consolidated Billing, DGS, PLR, etc) with flow of funds and timelines
- Regulatory approval, monitoring processes and regulatory risk
- The ISO credit and settlement policies
- The DGS and PLR contingency plans in case of default by one of the parties
- Etc.....

After all these issues are considered the credit exposure might be calculated as follows:

For Consolidated Billing: X days of the Billing Party’s customers projected average daily usage during the two months of the customers’ highest demand over the next twelve (12) months priced at the Utility’s applicable delivery tariff rate, including relevant competitive transition and customer charges.....

For DGS and PLR other methodologies might be more appropriate.

3. Determination of Proper Credit Limits

The issues listed under 2. above should be investigated before the proper credit limits are determined.

An unsecured line of credit should be granted to the parties rated BBB- or above (or equivalent) by two of the following three rating agencies: Standard and Poor’s, Moody’s, Fitch. For all other parties unable to meet this requirement, posting of acceptable security instruments for the entire credit exposure amount should be required.

The amount of the unsecured line of credit should be a function of the credit rating (probability of default) and of the size and financial strength of the counterparty. The tangible net worth (defined as total assets less intangible assets and total liabilities) is a common, simple financial ratio used to quantify the size and financial strength of companies. In addition, the unsecured line of credit should be capped to limit the risk exposure of the parties. The following table could be used to determine the unsecured line of credit:

Credit Rating			Max. Credit Limit to be calculated as the lesser of the % of TNW and credit limit cap below	
S&P	Moody's	Fitch	%	Credit Limit Cap
A-and above	A3 and above	A- and above	X% of TNW	\$XX,000,000
BBB+	Baa1	BBB+	X% of TNW	\$XX,000,000
BBB	Baa2	BBB	X% of TNW	\$XX,000,000
BBB-	Baa3	BBB-	X% of TNW	\$XX,000,000
Below BBB-	Below Baa3	Below BBB-	0% of TNW	0

As stated above, the exact amounts could be determined only after the issues listed in 2. are addressed.

At this stage, a discussion of the general principles to be used to determine the credit exposure and credit limits would make more sense!

Draft Creditworthiness Standards *Confidentiality*

Principles

- The information content of the creditworthiness process shall be deemed confidential and not subject to public disclosure.
- Any Confidential Information Provided shall be used only for the purpose of establishing the Applicant's financial status in order to enable the parties to enter into contracts for the products/services to be provided.
- If non-public information must be disclosed to the Applicable Regulatory Authority steps should be taken to insure the confidentiality of the information shall be maintained consistent with the Applicable Regulatory Authority's rules and regulations.

Definitions

- **“Confidential Information”**: nonpublic information that the Applicant discloses to the creditor to establish creditworthiness

Standards

- When entering into the creditworthiness evaluation process the Applicant and the Creditor shall execute a non-disclosure agreement.
- If the Creditor is required to disclose Confidential Information to the Applicable Regulatory Authority, it will:
 - notify the Applicant in writing prior to doing so, and
 - seek a protective order or other appropriate remedy from the Applicable Regulatory Authority..

Models

Sample Non- Disclosure Agreement: (Next Page)

**NON-DISCLOSURE AGREEMENT
(Example)**

Non-Disclosure Agreement between (Applicant) , having offices at (Address, City, State, Zip Code) ("Company"), and (Creditor) , having offices (Address, City, State, Zip Code) , is effective as of this the _____ day of _____, 200_ ("Agreement"). Company and Recipient may hereinafter be referred to individually as a "Party" and collectively as the "Parties".

"Confidential Information" means information that relates to the nonpublic financial information concerning the financial condition of Company or any of Company's Affiliates which is disclosed to Recipient by Company or any of Company's Affiliates. Confidential Information may be disclosed in written or other tangible forms (including on magnetic media), or by oral, visual, or other means. The term "Affiliate" as used in this Agreement means any person or entity directly or indirectly controlling, controlled by, or under common control with a Party.

Recipient of Confidential Information may use the Confidential Information only for the purpose of evaluating the financial status of Company and/or any of Company's Affiliates as such status relates to a determination by Recipient as to whether or not the Parties may enter into a written contract for the supply of electricity and/or gas.

Recipient shall protect such Confidential Information from disclosure to others, using the same degree of care used to protect its own confidential or proprietary information of like importance, but in any case using no less than a reasonable degree of care. Recipient may disclose Confidential Information received hereunder to (i) its Affiliates who agree, in advance, in writing, to be bound by this Agreement, and (ii) to its employees and independent contractors, and its Affiliates' employees and independent contractors, who have a need to know, for the purpose of this Agreement, and who are bound to protect the received Confidential Information from unauthorized use and disclosure under the terms of a written agreement. Confidential Information shall not otherwise be disclosed to any third party without the prior written consent of Company.

The restrictions of this Agreement on use and disclosure of Confidential Information shall not apply to information that:

- Was publicly known at the time of Company's communication thereof to Recipient;
- Becomes publicly known, through no fault of Recipient, subsequent to the time of Company's communication thereof to Recipient;
- Was in Recipient's possession free of any obligation of confidence at the time of Company's communication thereof to Recipient;
- Is rightfully obtained by Recipient from third parties authorized to make such disclosure without restriction; or
- Is identified by Company as no longer proprietary or confidential.

In the event Recipient is required by law, regulation or court order to disclose any of Company's Confidential Information, Recipient will promptly notify Company in writing prior to making any such disclosure in order to facilitate Company seeking a protective order or other appropriate remedy from the proper authority. Recipient agrees to cooperate with Company, at Company's expense, in seeking such order or other remedy. Recipient further agrees that if Company is not successful in precluding the requesting legal body from requiring the disclosure of the Confidential Information, Recipient will furnish only that portion of the Confidential Information, which is legally required to be furnished, and Recipient will exercise all reasonable efforts to obtain reliable assurances that confidential treatment will be accorded the Confidential Information.

Neither Party is obligated under this Agreement to purchase from or provide to the other Party any service or product.

This Agreement shall become effective as of the date first written above and shall expire one (1) year thereafter.

Neither Party may assign any of its rights or obligations hereunder, except to an Affiliate or successor in interest, without the prior, written consent of the other Party, which consent shall not be unreasonably withheld.

No failure or delay in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege hereunder.

11. This Agreement is the complete agreement of the Parties concerning the subject matter hereof and supersedes any prior such agreements with respect to further disclosures concerning such subject matter; (b) may not be amended or in any manner modified except by a written instrument signed by authorized representatives of both Parties; and (c) SHALL BE GOVERNED AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF (Creditor's State) WITHOUT REGARD TO ITS CHOICE OF LAW PROVISIONS.

If any provision of this Agreement is found to be unenforceable, the remainder shall be enforced as fully as possible and the unenforceable provision shall be deemed modified to the limited extent required to permit its enforcement in a manner most closely representing the intention of the Parties as expressed herein.

IN WITNESS WHEREOF, each of the Parties hereto has caused this Agreement to be executed by its duly authorized representative.

(Applicant Name)
a (state and type of organization).

(Creditor Name)
a (state and type of organization).

By : (if the above entity is a Limited Partnership
enter name of its General Partner)

By: (if the above entity is a Limited Partnership
enter name of its General Partner)

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____

Date: _____

Date: _____

Draft Creditworthiness Standards ***Security Instruments***

Security instruments provide a means for a party to reasonably ensure that funds will be available to pay for acquired services in the event of default on payment for those services. Affected parties may establish an agreement supported by one of several methods that provide security to the supplier and enables a business relationship. These security instruments include:

- Prepayment
- Cash Deposit
- Letter of Credit
- Letter of Guaranty
- Surety Bonds
- Security interest in collateral acceptable to the Utility

The product from this team will be an explanation and definition of each instrument, pros and cons for each, with the objective of providing recommendations to NAESB Board of Directors of which should be included as standards for the industry.

For the meeting in Houston on November 8 we will provide a handout that provides the above-mentioned description with pros and cons. A matrix will also be developed to support comparisons and discussion. We will provide you with a copy of the matrix by November 5.

We anticipate there will be a lot of discussion and ask to be placed early on the agenda and that we have at least one-half hour to make our presentation.

Draft Creditworthiness Standards ***Calling On Security***

1. Utility may call upon the security posted by the Supplier if the Supplier fails to pay the Utility after all of the following events occur:
 - The Utility provides notice to the Supplier of its intent to call upon the security posted by the Supplier unless the Supplier makes payment within five days;
 - Written notice of default is provided to the Supplier;
 - Payment is not made within the timeframe specified in applicable agreements or tariffs; and
 - Any applicable cure period ends.
2. The Utility may call upon the security posted by the Supplier without prior notice if the Supplier files a petition for bankruptcy (or equivalent, including the filing of an involuntary petition in bankruptcy against the Supplier, if the petition is not dismissed within 20 days).
3. The Utility may call upon the security posted by the Supplier without prior notice if the Supplier for any reasons ceases to provide service to its customers under the Utility's program.
4. If the Utility is not paid all amounts owed within 30 days of a Supplier ceasing service to all Customers in the Utility's service territory, the Utility may call upon the security.

If the Supplier, acting as a Billing Agent, has posted security with a Utility, the Utility will apply the security to the customers' delivery charges and customer late payment charges (if applicable) for any unpaid amounts due from customers.