

Working Draft - For Discussion Purposes Only

NYISO CREDIT ASSESSMENT METHODOLOGY

All Customers¹ shall be subject to the financial assurance requirements set forth in the NYISO tariffs and its Financial Assurance Policy. Pursuant to those requirements, the NYISO shall conduct a Credit Assessment of each Customer as part of the process in determining the amount of Unsecured Credit, if any, that shall be granted to a Customer. This document describes the methodology used by the NYISO in its Credit Assessment. The NYISO's Credit Assessment methodology is outlined below in three parts. Part I sets forth the NYISO's approach for Investment Grade Customers. Part II outlines the NYISO's approach for Unrated Customers. Part III provides the NYISO's approach for government entities.

PART I: INVESTMENT GRADE CUSTOMERS

Step One: Determination of the Starting Point

The NYISO will determine the Customer's senior long-term unsecured debt rating or issuer rating. The NYISO will then use the Customer's rating, in accordance with the NYISO tariffs, to determine the percentage of the Customer's Tangible Net Worth that shall serve as the starting point for the NYISO's Credit Assessment, in accordance with the Tangible Net Worth matrix set forth in the NYISO tariffs. The Tangible Net Worth matrix set is reproduced in Exhibit A along with an example of this determination.

Step Two: Determination of the Credit Score

The NYISO will determine a credit score ("Credit Score") ranging from minus 5 (-5) to plus 5 (+5) by taking into account various quantitative and qualitative indicators about the Customer. The Credit Score will then be used to determine any adjustment to the starting point for the Customer's Unsecured Credit.

Areas of the Credit Score

NYISO evaluates five major areas in its Credit Assessment based on an analysis of the Customer's balance sheet, income statement, and statement of cash flow for the most recent fiscal year end and interim periods. Four of these areas are quantitative in nature, including: (i) cash flows, (ii) liquidity indicators, (iii) leverage and debt coverages, and (iv) performance and profitability. The components of each area are shown in Exhibit B. The other area of the NYISO's Credit Assessment is qualitative in nature. The components of the qualitative area are also shown in Exhibit B.

¹ Capitalized terms not established herein are used as they are defined in the NYISO tariffs.

Working Draft - For Discussion Purposes Only

Calculation of the Credit Score

In calculating a Customer's Credit Score, the NYISO will first determine values for each component within the four major areas as shown in Exhibit C. The NYISO will then compare the value of each of the Customer's components to the median value of those components among the Customer's industry peer group, as shown in Exhibit D. The Customer's industry peer group will comprise those companies with identical or closely-related primary SIC codes. Based on this comparison, the NYISO will determine a score for each component of the quantitative areas, as shown in Exhibit E. The NYISO Credit Manager will assign a score to each component of the qualitative area. The NYISO will then average the scores of the components within each area to obtain an overall score for each area, as shown in Exhibit F. The overall score for each area is assigned a weighting factor, as shown in Exhibit G. The weighted overall scores for each of the five areas are then added together to determine the Customer's Credit Score. A percentage adjustment to the starting point for Unsecured Credit established in Step One will then be applied based on the Customer's Credit Score and subject to the Market Concentration Cap limitation established in the tariffs. Exhibit H is an example of a positive adjustment. Exhibit I is an example of a negative adjustment. Exhibit J is a recap of the Credit Assessment Methodology for both positive and negative adjustments.

The NYISO will periodically review the factors and approach used in determining a Customer's Credit Score to ensure that the process properly accounts for the factors affecting Customer creditworthiness. The NYISO may change the scoring factors used or the weight assigned to each one, as it deems appropriate. For example, should the credit quality of an associated industry peer group deteriorate to the point that favorable standing within that group were no longer a meaningful indication of Customer creditworthiness, the NYISO would determine whether another benchmark would be more appropriate and make any necessary changes to the methodology.

Working Draft - For Discussion Purposes Only

PART II: UNRATED CUSTOMERS

Step One: Determination of the Starting Point

At the request of an Unrated Customer, the NYISO will determine an Equivalency Rating by performing an analysis of the Customer's audited financial statements from the previous three years.² The NYISO will use a multi-variant regression analysis for this purpose that will create an Equivalency Rating based on known financial factors that have a direct relationship with the credit ratings of a select peer group. The NYISO's analytical model, which was developed by Investortools, Inc., takes account of eleven financial factors and has three variants: "corporate," "investor-owned utilities" and "natural gas."³

Steps Two & Three: Determining the Credit Score / Adjusting the Starting Point

The NYISO will proceed with the same Credit Assessment Methodology set forth in Part I, if the Customer's Equivalency Rating is determined to be BBB- (or Baa³) or higher. If a Customer's Equivalency Rating is determined to be below BBB- (or Baa³), then the Customer shall be deemed a Non-Investment Grade Customer and shall not be eligible for Unsecured Credit.

PART III: GOVERNMENT ENTITIES

Step One: Determination of the Starting Point

NYPA and LIPA may substitute accumulated net revenues or working capital for Tangible Net Worth in the NYISO's determination of a starting point for the Credit Assessment.

Municipal electric cooperatives may substitute one million dollars (\$1,000,000) for Tangible Net Worth in the NYISO's determination of a starting point for the Credit Assessment.

Steps Two & Three: Determining the Credit Score / Adjusting the Starting Point

The remainder of the Credit Assessment Methodology set forth in Part I shall apply to NYPA, LIPA, and municipal electric cooperatives.

² Values for the most recent three-year period are required to account for variable deterioration (improvements).

³ The results of historical testing, as of August 30, 2002, have confirmed that the regression model is accurate to within two rating increments 87.27%, 89.90%, and 97.37% of the time, respectively, for the Corporate, Investor-Owned Utility and Natural Gas sectors.