

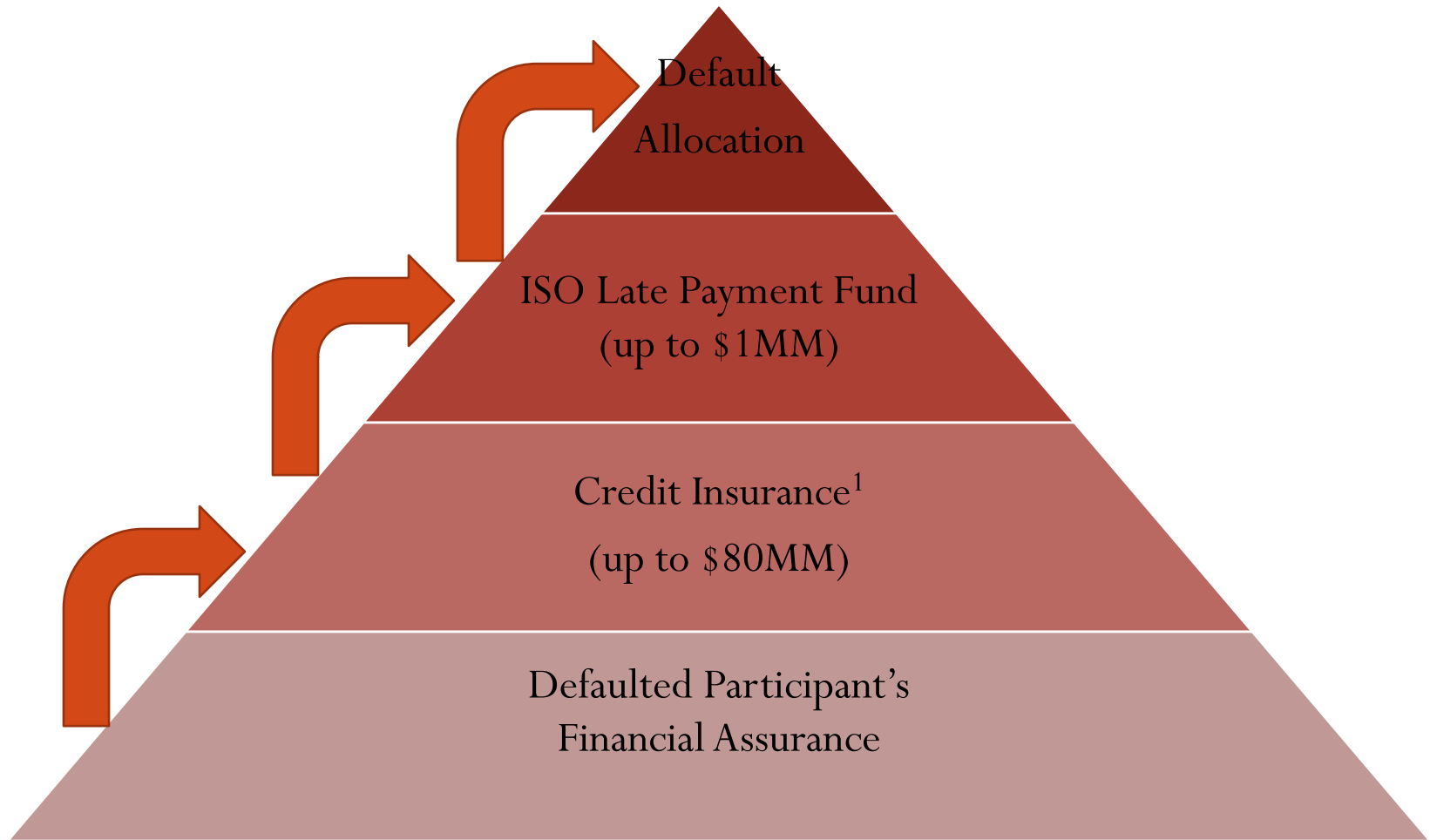
Discussion of FTR Default Allocation

Prepared For Consideration by
FTR Credit Working Group
May 23, 2008

Default Allocation Process: Highlights

- All participants exposed to potential burden resulting from payment default of other participants (mutualization)
- Participant's prorated share is calculated by summing the absolute value of the line items on the Participant's bill from the week in which the payment default occurred then dividing by sum of absolute value of all Participant's line items for the same bill
 - Calculation based upon invoice(s) where payment was not made
 - Obligors and creditors are subject to default allocation

Payment Default Allocation: Simplified Overview



¹Credit Insurance only covers investment grade participants listed on policy. Policy presents liquidity, regulatory & contract risk.

FTR Payment Defaults

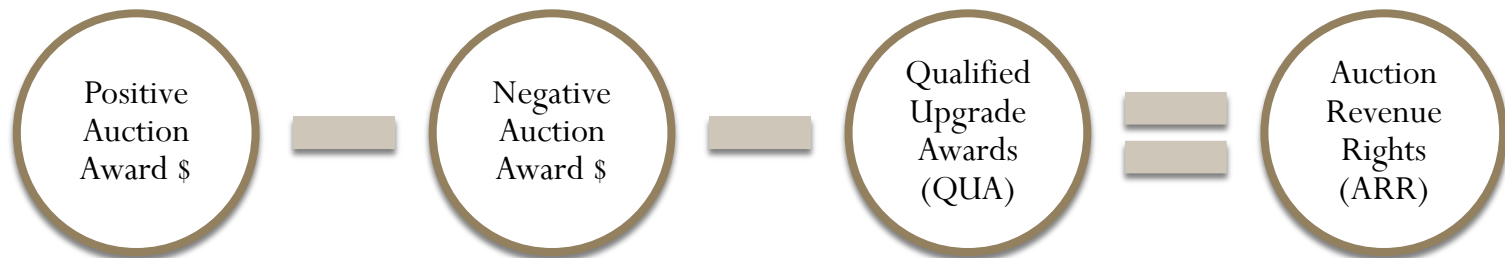
- At highest level FTR losses imply participant did not correctly value the rights
 - Paid too much in auction
 - Received too little from auction
- Who benefits from the FTR holder's error in valuation?
- Who loses?

FTR Payment Defaults – Who Wins?

- Win:
 - ARR Holders
 - ARR holders may “win” as a result of the FTR valuation error
 - The FTR auction is designed to award the set of simultaneously feasible FTRs representing the highest total auction award value
 - Maximizing auction award value results in the largest dollar amount available for ARR distribution
 - FTR Participants
 - Depending on the nature of the portfolio, other FTR participants may be better or worse-off as a result of the defaulted participant’s valuation error.
- Lose:
 - All Market Participants
 - Mutualized payment default allocation
 - FTR Participants
 - Depending on the nature of the portfolio, other FTR participants may be better or worse-off as a result of the defaulted participant’s valuation error.

FTR Revenue Stream

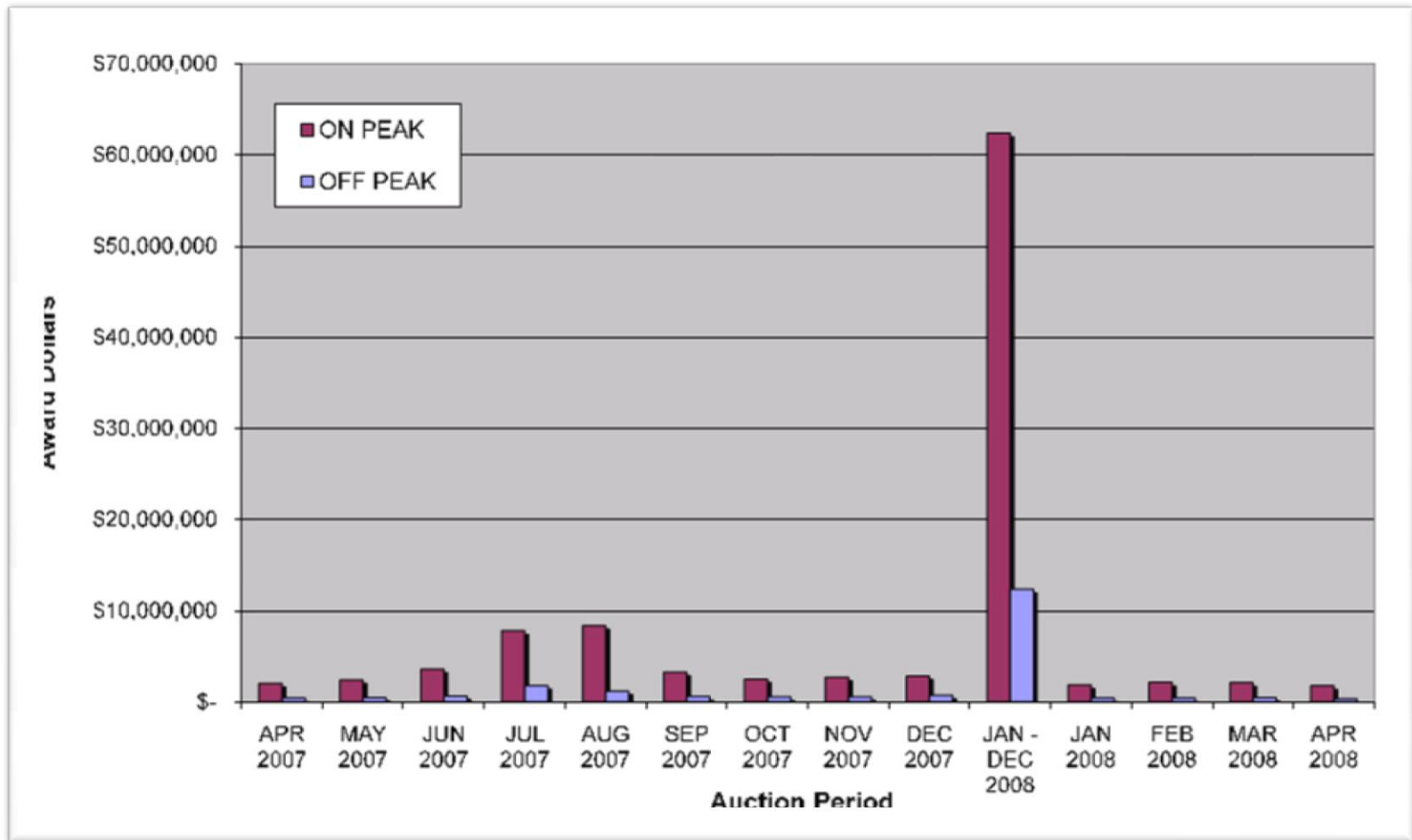
Auction Revenue



Congestion Revenue



FTR Auction Awards – ARR Dollars



Potential for Layering FTR Payment Default Allocations: ARR Funds

- **ARR Holders:** Is it appropriate to target ARR revenues first in the event of FTR default?
 - Capture inflated benefits resulting from poor FTR bid valuations
 - Source a portion of the default from ARR fund
 - ARR share may be determined by:
 - Assessing net change in ARR revenues when rerunning auction with and without defaulted participant's bids
 - Contribute to FTR default fund by hold back of set percentage of monthly ARR distributions

Potential for Layering FTR Payment Default Allocations: FTR Holders

- **FTR Participants:** Should FTR participants assume additional default risk?
 - May promote self-policing
 - Market presents default risk disproportionate to relative size and participation
 - Approx 40 bidders / auction
 - Less than 5% of total market dollars
 - FTR participants could be required to contribute to FTR default fund.
 - FTR participants contribute by way of a per bid assessment.
 - Contributors should be rebated their guaranty fund deposits when they no longer choose to participate in the FTR market (remove eFTR access, terminate).
 - Disallow FTR Default Fund withdrawals during FTR default period

Proposed FTR Default Allocation Process

