



POLICY NO. 005 – RISK MANAGEMENT PROCEDURES AND CONTROLS FOR TRANSACTIONS IN THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR MARKETS

1. Introduction

This policy sets forth the risk management policies related to MCE's transactions in the California Independent System Operator (CAISO) markets. The CAISO markets in which MCE participates and to which these policies apply include the following:

- Congestion Revenue Rights

2. Risk Exposure and Controls

MCE uses Congestion Revenue Rights (CRRs) for the exclusive purpose of hedging congestion costs associated with serving its customer load. MCE participates in the CAISO CRR allocation process to obtain CRRs that protect against congestion costs that may arise between its contractual energy supply points and its default load aggregation point. CRR positions are limited to the volume of MCE's anticipated energy schedules for the respective path and time period associated with the CRR. All CRR transactions are executed and managed by MCE's scheduling coordinator, Shell Energy North America, and confirmation of such transactions are provided to MCE personnel who are independent from the CRR trading function

a. Credit Risk

Credit risk refers to the potential for non-payment or default by the counterparty to a transaction. MCE's CRRs are financially settled with the CAISO through MCE's scheduling coordinator. CRR credit risk is mitigated due to the credit policies and procedures in place at the CAISO and the credit provisions governing MCE's agreement with its scheduling coordinator.

b. Liquidity Risk

Liquidity risk refers to the potential inability of a party to close out a position at prevailing market prices due to a lack of buyers or sellers for the specific product being liquidated. CRRs can be sold in the CAISO monthly and annual CRR auction markets. CRRs can also be sold bilaterally through the CAISO administered secondary registration system.

c. Market Risk

Market risk refers to potential cost exposure resulting from changes in market prices for the underlying commodity. CRRs have positive value when congestion exists between

the source and the sink associated with the CRR path such that locational marginal prices are lower at the source than at the sink. CRRs have negative value when the opposite is true. MCE uses CRRs exclusively to hedge against congestion costs, which are negatively correlated with CRR values, such that the potential adverse financial impacts of changes in CRR values and congestions costs are mitigated.

3. Training

MCE employees, contractors and agents transacting in CAISO markets shall meet all training requirement set forth in the CAISO Tariff or applicable CAISO Operating Agreement.

4. Monitoring and Reporting

a. Monitoring

CRR values shall be monitored at regular intervals, with such intervals selected in consideration of the risk characteristics of MCE's CRR holdings, but no less frequently than monthly. MCE personnel responsible for monitoring the value of MCE's CRR holdings shall be independent from those engaged in transacting in the CAISO's CRR markets.

b. Reporting

CRR values shall be reported on a monthly basis to the MCE Executive Officer and the Controller. Any material change in such CRR values or risks shall be identified and summarized in the aforementioned report.