**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105-3265**

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|  | Public Meeting held December 5, 2013 |
| Commissioners Present:  Robert F. Powelson, Chairman  John F. Coleman, Jr., Vice Chairman  James H. Cawley  Pamela A. Witmer  Gladys M. Brown |  |
| Public Utility Commission Bonding  Requirements for Electric Generation  Suppliers; Acceptable Security  Instruments | M-2013-2393141 |
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**TENTATIVE ORDER**

**BY THE COMMISSION:**

During the Public Utility Commission’s Investigation of Pennsylvania’s Retail Electric Market, Docket No. I-2011-2237952, the Commission issued an Order which directed an “Intermediate Work Plan” at that Docket (Order entered March 1, 2012), which directed several initiatives designed to provide improvements to Pennsylvania’s electric retail market. Among the initiatives directed was the formation of a risk assessment working group comprised of Electric Distribution Companies (EDCs), Electric Generation Suppliers (EGSs) and other interested parties to work with the Commission’s Office of Competitive Markets Oversight (OCMO) to examine current security requirements and security instruments which EGSs are required to post in order to operate in Pennsylvania’s retail electric market. The Working Group was formed on April 15, 2013. It is comprised of OCMO, EDCs, EGSs and representatives of the Retail Electric Supply Association (RESA).

On May 22, 2013, OCMO Staff presented background information to the Working Group regarding the Commission’s current bonding requirements for EGSs and a description of currently acceptable security instruments to support those requirements. OCMO Staff requested that the Working Group provide informal comments discussing potential modifications to those requirements, including:

* A reduction of the EGS security to be maintained after the first year of licensure, from 10% of annual gross receipts to 5% of annual gross receipts;
* Expansion of the acceptable financial credit instruments, to include Parental Guarantees and segregated cash accounts specific to Pennsylvania customers and callable only by the Commission.

OCMO Staff also requested informal comments on whether or not there could be a mix of security instruments to cover the Commission’s EGS bonding requirements. OCMO Staff advised the Working Group that given the limited resources the Commission has to both police collateral and execute on an instrument in the event of default, a blanket provision for customized security instruments for individual EGSs would not be considered. Finally, OCMO Staff sought informal comments as to whether there was a duplication of an EGS’s security obligations among the Commission, EDCs and the PJM Interconnection, LLC (PJM).

Informal comments were submitted by the following parties: Washington Gas Energy Services, Inc. (WGES); Integrys Energy Services (IES); FirstEnergy Solutions, Corp. (FES); Strategic Communications, LLC on behalf of Agway Energy Services (AES); Liberty Power, Corp. (Liberty Power); Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company (collectively, FE Operating Companies); Constellation NewEnergy, Inc. (Constellation); and RESA.

Upon review of the informal comments submitted to OCMO Staff, we believe that this issue is ready to move forward through the issuance of this Tentative Order and inviting formal comments on the proposal set forth below. After consideration of the comments filed in response, we will issue a final Order.

**Discussion**

The Commission’s current authority to establish EGS bonding requirements is set forth in Section 2809 of the Public Utility Code (Code), 66 Pa. C.S. § 2809 relating to requirements for electric generation suppliers. Specific details regarding the amount and form of security are found in the Commission’s regulations at 52 Pa Code § 54.40 relating to bonds or other security. The initial security level required from each EGS license applicant that intends to take title to electricity is $250,000. Typically this requirement has been fulfilled by Letters of Credit (LOC) or Surety Bonds. After the first year that the license is in effect, the security level for each license is reviewed annually and modified primarily based on the licensee’s reported annual gross receipts information.  The current security level to be maintained by licensee is 10% of the licensee’s reported gross receipts. 52 Pa. Code § 54.40(d).[[1]](#footnote-1) The purpose of this security level is to ensure payment of the Gross Receipts Tax (GRT) and to ensure the supply of electricity at retail in accordance with contracts, agreements or arrangements. 52 Pa Code § 54.40(f)(2).

As noted above, OCMO Staff sought informal comments on the amount of security to be posted after the initial year of service suggesting a reduction in the amount from 10% to 5%. OCMO Staff also sought informal comments relating to the type of security instruments which should be deemed acceptable as well as whether a mix of security instruments could be used to secure a single EGS’s obligation. Finally, OCMO Staff sought comments on whether there was a duplication of an EGS’s security obligations among the Commission, EDCs and PJM.

**Summary of Comments**

WGES commented on each of the three areas of inquiry. WGES supports the initial proposal that, after the first year of operation, the security requirement should be reduced from 10% to 5% of annual gross receipts. WGES explains that as its business has grown in Pennsylvania, the expense of maintaining a bond in the amount of 10% of annual gross receipts has become “onerous.” WGES also asserts that the current level of Pennsylvania’s gross receipts tax (GRT) is 59 mills, which is much closer 5% of annual revenues than 10%.

WGES also agrees that the universe of acceptable security instruments should be expanded. WGES states that the Commission should accept parental guarantees in addition to bonds and LOCs, so long as the parent providing the guarantee is an investment grade company rated as such by a rating agency. If the parent is not an investment grade company, WGES recommends that a bond be required.

WGES states that its agreement with a reduction in the amount of security is bolstered by the fact that PJM’s security requirements are designed to cover an EGS’s supply obligations. WGES explains that the EDC assigns the load responsibility to the EGS and informs PJM of that responsibility. PJM’s collateral requirements are tied to the size of an EGS’s load obligations, among other costs. Accordingly, to the extent the Commission’s requirements also seek to cover that risk, they are duplicative of PJM’s requirements.

IES generally supports the preliminary OCMO Staff proposal to reduce the bonding requirement after the initial year of operation from 10% to 5% as well as an expansion of the type of acceptable security instruments.

FES believes that it is appropriate to reduce the EGS security after the first year of licensure to 5% of annual gross receipts. FES states that for larger companies, the current 10% level requires the posting of an inordinately large bond at a substantial cost to the company, which is then passed on to customers in the form of higher prices. FES comments that the current 10% bond requirement far exceeds the potential credit risk it purports to cover and is much larger than bonding requirements in other states.

FES also supports an expansion of the type of acceptable security instruments. FES believes that acceptable security instruments should include surety bonds, letters of credit, parental guarantees from investment grade parents, or cash. FES states that while segregated accounts should be included as acceptable instruments, they are costly and require more oversight than other forms of security. FES also believes that a mix of security instruments for a single entity should be acceptable, although FES does not use that form.

AES comments that to the extent the Commission seeks security for an EGS’s obligation to provide electric supply, that requirement would duplicate PJM’s security obligations. AES observes that such duplication is costly to the EGSs operating in Pennsylvania’s retail market.

Liberty Power supports a reduction in the bonding requirement after the first year of licensure. Liberty Power also comments that Texas provides a reasonable example of flexibility with regard to the nature of acceptable security instruments. Liberty Power states that Texas provides a fairly wide scope of entities that can act as guarantors on behalf of an EGS (or, REP in Texas). Acceptable guarantors include affiliates of an EGS that use guarantee forms approved by the Texas Commission; affiliates of an EGS that maintain security instruments that support credit or collateral requirements associated with power purchase agreements and for security associated with participation at ERCOT;[[2]](#footnote-2) the guarantor is a financial institution that maintains an investment-grade credit rating and maintains security instruments that support credit or collateral requirements associated with power purchase agreements and for security associated with participation in ERCOT; or the guarantor is a wholesale supplier to the EGS, or one of the power provider’s affiliates, and the entity maintains security instruments that support credit or collateral requirements associated with a power purchase agreement and for security associated with participation in ERCOT. Liberty Power particularly directs the Commission’s attention to the opportunity to use a wholesale supplier for an EGS as a guarantor of that EGS’s security requirements.

The FE Operating Companies express concern about reducing the bonding requirement after the initial operating year from 10% to 5%. They note that Section 2809(c)(2) of the Code, 66 Pa. C.S. § 2809(c)(2), provides that in event of an EGS default on the GRT, the EDCs are required to pay those taxes on behalf of the EGS. In addition, the FE Operating Companies observe that this Commission’s regulations at 52 Pa. Code § 54.40(f)(3) provide that payment to the EDCs as reimbursement of GRT is given the lowest priority of payout under the bonds. On that basis, the FE Operating Companies state that unless there is some relief from an EDC’s obligation to backstop EGSs on the GRT, either through legislative change or Commission permission to the EDC to collect GRT payments on a nonbypassable basis with full and current recovery, they cannot support a reduction in the bond requirement.

The FE Operating Companies do support expansion of the type of credit instruments acceptable to support the obligation. They support use of a parental guarantee provided the parent has an investment grade rating from one of four specified rating agencies. They also support the use of segregated cash accounts; provided the Commission defines what acceptable institutions could hold such accounts and specify that EGSs are responsible for account fees payable. The FE Operating Companies also support the use of a mixture of security instruments noting that the Commission can insist on a particular format for any approved security instruments.

Constellation agrees with the initial security of $250,000 required for the first year of operations. However, Constellation believes that the subsequent adjustment to 10% of annual gross revenues is significantly higher than necessary to meet the stated goals and is completely inconsistent with other states’ requirements. Constellation points out that EGSs are required to prepay 90% of the expected annual GRT in the first quarter of each year directly to the Pennsylvania Department of Revenue. Accordingly, Constellation asserts that a requirement to post security of 10% of gross annual revenues is considerably more than necessary to cover any additional risk of unpaid GRT beyond the 90% prepaid by the EGS.

Constellation also asserts that an EDC risk in the event of an EGS default on supply is only the difference between the EGS contract price and the cover price for the electricity, not the entire cost of the electricity supply. Constellation argues that the highest level of security an EGS is required to post in competitive states around Pennsylvania is $350,000. This includes Maryland, Illinois, New Jersey, Connecticut, New Hampshire and Massachusetts. Constellation supports a reduction in the amount from 10% to 5%, but believes the requirement could be reduced further without jeopardizing the state’s goals.

Constellation also supports expanding the type of acceptable security instruments. Constellation notes that EGSs now secure their obligation through bonds or LOCs. Constellation argues that both forms of security are costly (typically between .5% - 3% of the collateral amount) but can also tie up significant amounts of cash. Constellation asserts that in Pennsylvania, the current requirements can result in obligations of tens of millions of dollars for a single EGS, compared to $350,000 as noted above. Accordingly, Constellation recommends accepting parental guarantees from an investment grade entity, particularly if the annual posting requirement remains at 5%-10% of annual gross receipts.

RESA comments that the purposes for the security requirement in Pennsylvania are: to ensure compliance with the Code and the Commission’s regulations; to ensure payment of the GRT; and to ensure the supply of electricity at retail in accordance with contracts, agreements or arrangements. RESA asserts that the Department of Revenue already addresses the issue of GRT payments by demanding that EGSs make payment every year by March 15 which include: any balance due for GRT liability from the previous year; prepayment towards the current year’s GRT liability, which must equal 90% of the reported tax due and 100% of the reported liability for the second prior year. According to RESA, this prepayment requirement significantly reduces the risk of not collecting GRT liability. Because the GRT risk is significantly reduced, RESA argues that it makes a great deal of sense to reduce the Commission’s current bonding requirement.

RESA also comments that the other purposes for the bonding requirement do not require the current level of security. RESA states that the Commission has always enforced its rules and regulations through rulemakings and adjudications in instances where violations occur. According to RESA, a reduction in the bonding requirement will have no impact on the Commission’s continued ability to engage in those types of enforcement actions. As to the risk of default on supply obligations, RESA argues that the actual exposure is small. First, if the customer moves to another EGS offering prices at or lower than the customer’s product with the defaulting EGS, there is no exposure. If the customer moves to default service or a higher priced product, the only exposure is the difference between the price charged by the defaulting EGS and price of the new product. RESA comments that the price differential should not be so significant as to warrant an excessive bond.

In view of the level of risk actually associated with EGS activities, RESA recommends that the bonding level for EGS applicants and established EGSs be set at $250,000, unless the Commission finds that an increase is necessary to comply with the laws and rules of the Commission, to pay taxes owed, or to ensure delivery of electric supply to customers pursuant to contracts. RESA comments that the proposed reduction of the bonding level to 5% of annual gross receipts is still too high. RESA poses a hypothetical in which an EGS with $10 million in gross receipts would have a $590,000 GRT liability, assuming a 5.9% GRT rate. With the requirement of a 90% prepayment, that EGS will prepay at least $531,000 of the GRT liability. The total exposure to the Commonwealth is $59,000. Under the proposed reduction to 5% of gross receipts, RESA submits that the actual security amount for its hypothetical EGS would be $500,000 to secure an obligation of $59,000.

RESA points to neighboring jurisdictions and observes that Maryland requires suppliers to post security in the amount of $250,000. When that security instrument expires, the Maryland Commission may decide that no further security is required if certain financial conditions are met. In New Jersey, RESA states that the initial security requirement is $250,000. After the first year, that amount is continued, but the Board of Public Utilities has the discretion to increase that amount if necessary.

Based on the foregoing, RESA suggests that the Commission establish an initial security requirement in the amount of $250,000. Upon expiration of that security instrument, the EGS would be required to renew its security in the amount of $250,000, unless directed to increase or reduce that amount by the Commission. Should the Commission adopt the OCMO Staff proposal, RESA recommends that the initial $250,000 requirement can be met by the current obligation to post a bond or a LOC. However, in subsequent years, while $250,000 requirement could be met by a bond or LOC, the remaining security requirement to reach 5% of annual gross receipts could be satisfied by another form of security instrument or combination of security instruments.

RESA also supports expanding the type of security instruments that the Commission would accept. RESA suggests the Commission consider: reliance on investment-grade long-term bond ratings from two of the four major rating agencies; a guarantee, issued by a corporation, co-partnership, or other person or association, or by a qualified subsidiary, affiliate of the EGS, or a qualified corporation holding controlling interests in the EGS; a copy of the security or agreement that was provided and approved by PJM or other RTO and used to serve as collateral; a combination of any or all of the types of the foregoing instruments.

RESA suggests that the Commission examine other jurisdictions and determine whether security instruments acceptable there could also be used in the Commonwealth. RESA points to Delaware as a state with a flexible approach to security instruments. For example, Delaware permits: cash or cash equivalents; certificates of deposit or other liquid deposit; preferred stock proceeds or other corporate shareholder equity; LOC or line of credit; loan; corporate guarantee; and identifiable physical assets set forth in a balance sheet or similar statement.

RESA also responded to OCMO Staff’s request for comments on overlapping security obligations. RESA reiterated its position that the Department of Revenue adequately protects against default on GRT liability by the prepayment requirement. Similarly, RESA argues that PJM’s security requirements and the individual EDC security requirements protect against exposure from supply default.

**Tentative Proposal for Reduction in Security Requirements and Expansion of Acceptable Security Instruments**

Based upon our review of the OCMO Staff’s informal proposal, and the comments submitted thereto, it appears that our current requirement for an initial bonding amount of $250,000 for EGSs that intend to take title to electricity is reasonable and should remain in force for the initial year of operation. It also appears, however, that the subsequent requirement of a bond or LOC in the amount of 10% of annual gross receipts may be excessive in relation to the risk intended to be secured, may be unnecessarily burdensome and may present a barrier to entry into Pennsylvania’s retail electric market. As such, the Commission is proposing to maintain the current requirement for an initial bonding amount of $250,000 for the first year and to reduce the subsequent security requirement from 10% of annual gross receipts to 5%.

Furthermore, based upon our review of the OCMO Staff’s informal proposal and the comments submitted thereto, it appears that it would be reasonable to expand the types of security instruments that should be accepted by the Commission. Specifically, it appears that the following types of security should be acceptable:

* Parental guarantee, in a form acceptable to the Commission, where the parent maintains an investment-grade long-term bond rating from two of the four rating agencies:

Standard & Poors BBB- or higher

Moody’s Investors’ Services Baa3 or higher

Fitch IBCA BBB- or higher

Duff and Phelps Credit BBB- or higher

Rating Company

* Segregated cash accounts, held by federally insured financial institutions, specific to Pennsylvania customers and callable only by the Commission
* A mix of bonds; LOCs; Parental guarantees and/or segregated cash accounts as set forth above sufficient meet the required security in the amount of 5% of annual gross receipts.

We invite comments from interested parties on the proposals set forth above, both as to the level of the security requirement and the nature of acceptable security instruments. In addition, we invite comment on whether these proposals require a change to our current regulations to be implemented or whether the Commission can temporarily waive the current regulations until a formal regulation change is completed or whether these changes can be implemented under the current regulation provision that allows the Commission to set an alternative level of bonding commensurate with the nature and scope of the EGSs operations.[[3]](#footnote-3)

**Conclusion**

Based upon the foregoing discussion, we seek comment on whether the current level of security required for EGS operations after the initial year of service may be excessive, burdensome and a potential barrier to entry. We also seek comment on whether the types of acceptable security instruments should be expanded. Furthermore, we seek comments on whether these changes can be implemented prior to or without a change to our current regulations. In order to facilitate public comment on these issues, we will establish a 20 day comment period from the date this order is published in the *Pennsylvania Bulletin*; **THEREFORE,**

**IT ORDERED:**

1. That comments to this Tentative Order shall be filed within twenty (20) days of the publication of this Order in the *Pennsylvania Bulletin*.

2. That an original copy of the comments shall be filed with the Commission’s Secretary at:

Pennsylvania Public Utility Commission

P.O. Box 3265, Harrisburg, PA 17105-3265.

Comments may also be filed electronically through the Commission e-filing system, in which case no paper copy needs to be filed with the Secretary provided that the comments are less than 250 pages.

3. That this Tentative Order shall be served on all Electric Distribution Companies, all licensed Electric Generation Suppliers, the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, the Pennsylvania Department of Revenue and the Energy Association of Pennsylvania.

4. That the Secretary shall deposit a copy of this Tentative Order with the Legislative Reference Bureau for publication in the *Pennsylvania Bulletin*.

5. That a copy of this Tentative Order shall be posted on the Commission’s website at the Office of Competitive Market Oversight’s web page.

6. That the Office of Competitive Market Oversight shall electronically serve a copy of this Tentative Order on all persons on the contact list for the Committee Handling Activities for Retail Growth in Electricity.

7. That the contact person for technical issues related to this Tentative Order is

Brent Killian, Technical Utility Services Bureau (717) 783-0350. That the contact person for legal issues related to this Tentative Order is H. Kirk House, Assistant Counsel, Office of Special Assistants, (717) 772-8495.

8. That a Final Order shall be issued subsequent to the receipt and evaluation of any comments filed in accordance with this Tentative Order.



**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: December 5, 2013

ORDER ENTERED: December 5, 2013

1. It should be noted that the Commission’s current bonding requirements for an EGS license after the initial year of operation provide for a $250,000 security requirement or 10% of reported gross receipts, whichever is higher. [↑](#footnote-ref-1)
2. “ERCOT” is the Energy Reliability Council of Texas and operates as the Regional Transmission Operator for the State of Texas, somewhat similar to PJM’s role in the operation of the transmission grid in the Mid-Atlantic States. [↑](#footnote-ref-2)
3. See 52 Pa. Code § 54.40(d). [↑](#footnote-ref-3)