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June 3, 2009

VIA E-FILING
James J. McNulty, Secretary
Pennsylvania Public Utility Commission
400 North Street – 2nd Floor
Commonwealth Keystone Building
Harrisburg, Pennsylvania 17120

Re: Licensing Requirements for Natural Gas Suppliers; *SEARCH Final Order and Action Plan:* Natural Gas Supplier Issues, Docket Nos. L-2008-2069115, I-00040103F0002

Dear Secretary McNulty:

Enclosed is a copy of The Retail Energy Supply Association ("RESA") comments to the Proposed Rulemaking Order issued by the Pennsylvania Public Utility Commission on December 8, 2008 in the above-captioned proceeding. Copies of this document have been served in accordance with the attached Certificate of Service.

Very truly yours,

Matthew A. Totino

Enclosures
MAT:ck

c. Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Licensing Requirements for Natural Gas	:	
Suppliers; *SEARCH Final Order and Action*	:	Docket Nos. L-2008-2069115
Plan: Natural Gas Supplier Issues	:	I-00040103F0002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the relevant documents in accordance with the requirements of 52 Pa. Code § 1.54 et seq. (relating to service by a participant).

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Dated: June 3, 2009

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Licensing Requirements for Natural Gas Suppliers; *SEARCH Final Order and Action Plan:* Natural Gas Supplier Issues	:	Docket Nos. L-2008-2069115 I-00040103F0002

Comments of the Retail Energy Supply Association
to Proposed Rulemaking Order

The Retail Energy Supply Association ("RESA")[1] submits these comments to the Proposed Rulemaking Order ("Order") issued by the Pennsylvania Public Utility Commission ("Commission") on December 8, 2008 in the above-captioned docket. The Order provides that any written comments to the proposed rulemaking are to be submitted within 60 days of publication in the Pennsylvania Bulletin. The Order was published in the Pennsylvania Bulletin on April 4, 2009.

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[1] RESA is a non-profit trade association made up of a broad range of companies that are involved in wholesale generation of electricity and the competitive supply of natural gas to residential, commercial and industrial consumers. RESA and its members are actively involved in the development of retail and wholesale competition in natural gas and electricity markets in various states throughout the country, including Pennsylvania. RESA's members include Commerce Energy, Inc; Consolidated Edison Solutions, Inc; Direct Energy Services, LLC; Exelon Energy Company; Gexa Energy; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Liberty Power Corp.; RRI Energy; Sempra Energy Solutions LLC; SUEZ Energy Resources NA, Inc. and US Energy Savings Corp. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

I. Introduction

The Order arose out of the Commission's stakeholder process known as SEARCH, which was established to explore avenues for increasing competition in Pennsylvania's retail natural gas supply service market.[2] The Stakeholders were directed to examine issues that are relevant to the retail natural gas supply service competitive market and to develop recommendations regarding changes in market structure and operation, including any necessary amendments to the Public Utility Code ("Code") and the Commission's regulations. The SEARCH process culminated in a Final Order and Action Plan ("SEARCH Final Order") that, among other things, proposed to revise the Commission's natural gas supplier ("NGS") licensing regulations at 52 Pa. Code §§ 62.101-114 regarding the level and forms of security needed for licensing.[3] The NGS licensing requirements were identified by the Commission in the *SEARCH* order as one barrier to supplier participation in the retail gas market.

At the public meeting of December 4, 2008, the Commission adopted the Order, which proposes to update the Commission's existing NGS licensing regulations to better balance the ability of an NGS to provide adequate security with the NGDC risk of a supplier default. In particular, the Commission in its Order addresses the following matters: (1) the use of NGS accounts receivables in purchase of receivables programs as

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[2] Pursuant to Section 2204(g) of the Public Utility Code, 66 Pa. C.S. § 2204(g), the Commission was required to determine whether "effective competition" existed within the natural gas market in Pennsylvania. By order entered on October 6, 2005, the Commission concluded that "effective competition" did not exist in Pennsylvania's natural gas market. *See Investigation into the Natural Gas Supply Market; Report to the General Assembly on Competition in Pennsylvania's Retail Gas Market*, Docket No. I-00040103. The Stakeholders Exploring Avenues for Removing Competition Hurdles proceeding or "*SEARCH*" was convened in response to this finding.

[3] Code Section 2208(c)(1)(i) establishes the security requirements for the issuance and maintenance of an NGS license in Pennsylvania. This section authorizes the NGDC to determine the amount and form of the bond requirement or other security using criteria that is subject to periodic review by the Commission. Accordingly, the Commission has the authority to review criteria used by NGDCs to establish the form and level of security.

fulfillment of some or all of security requirements; (2) the adoption of standard language for financial instruments used for security; and (3) the development of reasonable criteria for NGDCs to use to establish the amount of security necessary for licensing purposes.

RESA appreciates this opportunity to provide written comments in this important rulemaking. As noted in *SEARCH* and as determined by the Commission in its *SEARCH* Final Order, revising the NGS licensing regulations is one of the measures necessary to achieve effective competition in the natural gas market in the Commonwealth. RESA commends the Commission for its ongoing effort to achieve effective competition in the natural gas market and to provide interested parties with a meaningful opportunity to participate in the process through such vehicles as this rulemaking.

As discussed in more detail below, RESA supports the proposed revisions to subsections 62.111(c)(1)(ii) and 62.111(c)(2) of the Commission's regulations because they are necessary to remove competitive barriers to entry. And, RESA proposes additional revisions to section 62.111 to further facilitate competition in Pennsylvania's natural gas supply market.

II. Specific Comments

Proposed RESA Revision to Section 62.111(c)(1)

Section 62.111 of the Commission's regulations addresses security requirements for an NGS. RESA proposes a revision to 62.11(c)(1) that was not included as part of the Commission's revisions in the proposed rulemaking. This revision, which is necessary to ensure uniform licensing security requirements throughout the Commonwealth, would establish a statewide formula to be used by all NGDCs in Pennsylvania to calculate the amount of security owed.

Section 62.111(c)(1) establishes a general rule regarding the amount of security a NGDC may require a NGS to provide. The only specific guidance this section provides is that "the amount of security should materially reflect the difference between the cost of gas incurred and the supplier's charges, if any, incurred by the NGDC or supplier of last resort during one billing cycle." This provision has resulted in different NGDCs developing different formulas for calculating the level of security required of an individual NGS. The use of different formulas throughout the state makes it difficult for suppliers to operate on multiple systems and results in some NGDC security requirements being more stringent than others.

Such a lack of consistency operates as a barrier to entry to NGSs. Consequently, RESA proposes that the Commission revise Section 62.111(c)(1) to set forth a single formula that all NGDCs throughout the state must utilize to calculate the security requirements of the NGSs operating on their systems. RESA proposes that the Commission utilize the following formula:

> Security cannot exceed the NGS' customers' MDQ times the peak forecasted NYMEX price for the next 12 months and for upstream capacity to the city gate times 10 days.

NGSs should be permitted to request a peak (winter) and an off-peak (summer) security calculation to reflect the decrease in customer load, and thus a reduction to the NGDC's risk of supplier default, during the off-peak period. This formula, which is based on the formula utilized in New York's Uniform Business Practices, would calculate security based on published gas price forecasts, as well as the cost of capacity (generally calculated as the weighted average cost of capacity), which would most accurately reflect the costs and risks a NGDC would face upon supplier default.

Proposed Commission Revisions to Section 62.111(c)(1)(ii) with Additional Proposed Revisions by RESA

Through the proposed revisions to the above subsection, the Commission seeks to establish more stringent standards under which an NGDC can seek creditworthiness reviews of and security adjustments from an NGS. The Commission seeks to impose a more stringent triggering event for creditworthiness reviews or security adjustments by specifying that such action can only occur with <u>significant</u> changes in an NGS's operations that would <u>materially</u> affect the NGDC's operations or reliability.

RESA supports the proposed revisions to this subsection and believes that they will remove competitive barriers to entry by reducing the cost associated with frequent revisions to NGS security requirements. As reported by suppliers in the *SEARCH* process, the cost of bonds and letters of credit has increased as NGS sales have grown. And, the Commission's current regulations allow for adjustments to the security amount as frequently as every six months. The proposed revisions limit the events that can trigger a creditworthiness review and security adjustment to only significant changes that materially effect an NGDC's system operations and reliability. These revisions will ensure that adjustments in security are reasonable, which is the stated intent of the supplier licensing regulations.

Although RESA applauds the Commission's decision to impose stricter standards governing when a NGDC can seek a creditworthiness review of and security adjustment from a NGS, RESA proposes that additional revisions to subsection 61.111(c)(2) are necessary to further ensure that the NGS licensing requirements do not remain as a competitive barrier to entry. RESA submits that the following two proposed additions to this subsection are necessary to attract new suppliers to Pennsylvania and to increase the presence/activity of existing suppliers.

First, the Commission should add a new subsection 62.111(c)(1)(iii) to its licensing regulations to permit NGSs to request a decrease in security requirements under certain conditions where it is apparent that there is a reduction in the risk of a supplier default. RESA's proposed language is as follows:

> (iii) A licensee is permitted to request a reduction in the amount of security upon: (A) a ratings upgrade to the minimum rating level established in Section 62.111(c)(7)[4] by at least two of the three following rating agencies: Standard and Poor's Ratings Services, Moody's Investors Service, Inc. and Fitch, Inc.; (B) a significant reduction in the total usage of the customers served by the NGS and such reduction is sustained for at least 30 days, or (C) a significant decrease in gas supply costs and such decrease is sustained for at least 30 days. A NGDC shall provide its decision, in writing, to the NGS requesting the reduction within 5 calendar days of receiving the request.

RESA proposes that "significant" be defined as a reduction of 25% in total customer load or in gas supply costs. RESA believes that reducing collateral because of a reduction in customer usage or in natural gas prices is appropriate because these circumstances would yield a significant change in supplier operations or market conditions that, in turn, would significantly reduce a NGDC's risk of a supplier default. RESA further believes that a time-limit for a decision on the request is necessary to ensure timely action and to avoid any unnecessary delay.

Second, the Commission's regulations should contain a baseline creditworthiness standard that, if met, would satisfy the statutory security requirement of Code Section 2208(c) and thus would obviate the need for the NGS to post collateral. This baseline for creditworthiness would be an investment grade credit rating or its equivalent, and should

[4] See below for discussion of proposed addition of minimum credit rating as an alternative to the requirement to post collateral.

be added as a new subsection 62.111(c)(7) in Subpart C, Subchapter D of the Commission's regulations. RESA's proposed language is as follows:

> (7) An NGS that provides written proof that it maintains a minimum credit rating from two of three credit rating agencies shall be deemed to satisfy the Commission's security requirements of this Subchapter. For purposes of this subsection, minimum rating shall mean a rating of BBB from Standard and Poor's Ratings Services, Baa2 from Moody's Investors Service, Inc. or BBB from Fitch, Inc. A NGS that is not rated by these agencies may provide written proof of an equivalent rating from a similar rating agency.

RESA believes that a minimum threshold security requirement is warranted to reflect the reduced risk associated with an NGS that has a favorable investment grade/credit rating. RESA is aware that Code Section 2208 requires a licensed NGS to furnish a bond or other security as part of financial fitness. However, RESA's proposed minimum threshold does not eliminate the need to provide security. Rather, the written proof of investment grade/credit rating would be the security.

Proposed Commission Revisions to Section 62.111(c)(2) with Additional Revisions Proposed by RESA

Section 62.111 of the Commission's regulations also addresses the legal and financial instruments to serve as acceptable security or form of security. The Commission proposes to revise the list of acceptable security instruments to include escrow accounts, accounts pledged to the NGDC or sold by a participating NGS in a Commission-approved NGDC purchase of receivables ("POR") program,[5] and "calls on capacity" or other operational offsets that may be mutually agreeable to an NGDC and NGS.

[5] Under a POR program, the NGDC purchases a NGS's accounts receivable, typically at a discount. The discount may be attributable to uncollectible expense, *i.e.*, bad debt of the NGS's customers, and the NGDC's administrative costs for billing and collection.

As stated in *SEARCH*, the acceptance of only certain financial instruments is viewed as a competitive barrier to entry. RESA supports the proposed revisions to this subsection to expand the forms of acceptable security and believes that such revisions are necessary to attract new suppliers to Pennsylvania and to increase the presence/activity of existing suppliers.

Specifically, RESA supports the Commission's decision to include the purchase of NGS receivables as an acceptable form of security. The addition of the accounts receivable sold as part of a POR program is particularly appropriate, in light of the following: (i) receivables are a current asset of an NGS; (ii) the pledging of receivables is a traditional means to provide working capital; and (iii) the pledging of receivables is customarily referenced to credit card style asset backed securities. As noted in *SEARCH*, the use of a POR program can establish a relationship of trust and confidence between an NGDC and an NGS, thereby lessening the need for a credit review and an adjustment in a security level when the credit ratings of an NGS or its parent are downgraded for reasons unrelated to its immediate business interaction and relationship.

RESA does believe, however, that Section 62.111(c)(2) could be strengthened by the addition of another form of collateral that could satisfy a NGDC's security requirement. Suppliers often sell natural gas supply to NGDCs, for the NGDC's sale to their customers, and the NGDC pays the NGS for its gas supply purchases. At the same time, NGSs are posting collateral to cover the NGDC's risk of supplier default. It makes little sense for money to change hands twice for these transactions. Instead, the amount of money the NGDC owes to the NGS for the gas supply purchases could operate as an offset to the NGS's collateral requirement. In the event of a supplier default, the NGDC could retain the amount owed to the NGS. In the event that the NGDC's gas purchases are insufficient to fully offset the NGS's collateral obligations, the NGS would be required to post collateral to cover the difference between the full security requirement and the offsetting amount of the NGDC's purchases.

RESA's proposed changes to Section 62.111(c)(2)(vi) are as follows (additional language is reflected in brackets in underlined type):

> (vi) Calls on capacity <u>[, netting of NGDC gas supply purchases against NGS collateral requirements]</u> or other operational offsets as may be mutually agreed upon by the NGDC and the NGS.

Proposed Revisions to Section 62.111(c)(4)

RESA has no comments regarding this subsection.

Proposed Revisions to Section 62.111(c)(5)

RESA has no comments regarding this subsection.

Proposed Revisions to Section 62.111(c)(6)

RESA supports the addition of this subsection that lists the Commission processes, both formal and informal, that an NGS may pursue to resolve a dispute with a NGDC on the form and/or amount of security. RESA believes that the addition of this subsection is necessary and appropriate because it seems to promote the use of informal mechanisms to resolve disputes while, at the same time, it preserves a party's right to proceed with formal litigation if necessary.

III. Conclusion

RESA applauds the Commission's efforts to remove barriers to entry and increase the competitiveness of Pennsylvania's retail natural gas markets by revising regulations governing creditworthiness and security. The Commission's proposed revisions to the regulations, combined with RESA's suggested revisions discussed in these comments are necessary to ensure that the rules regarding creditworthiness and security requirements are fair, balanced and do not operate as a disincentive to supplier participation in the Pennsylvania gas markets.

Dated: June 3, 2009

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