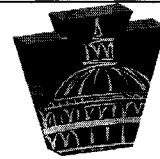


Regulatory Analysis Form

(Completed by Promulgating Agency)



IRRC

Independent Regulatory Review Commission

SECTION I: PROFILE

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(1) Agency:

PA Public Utility Commission

(2) Agency Number:

Identification Number:

L-2008-2069115/57-266

IRRC Number:

2754

(3) Short Title:

Licensing Requirements For Natural Gas Suppliers; *SEARCH Final Order and Action Plan*: Natural Gas Supplier Issues

(4) PA Code Cite:

52 PA Code § 62.111 (relating to bonds and other security)

(5) Agency Contacts (List Telephone Number, Address, Fax Number and Email Address):

Primary Contact:

Patricia Krise Burket, 717-787-3464, P.O. Box 3265, Harrisburg, PA 17105-3265, 717-783-3464, pburket@state.pa.us

Secondary Contact:

Sherri A. DelBiondo, 717-772-4597, P.O. Box 3265, Harrisburg, PA 17105-3265, 717-783-3458, sdelbiondo@state.pa.us

(6) Primary Contact for Public Comments (List Telephone Number, Address, Fax Number and Email Address) – Complete if different from #5:

(All Comments will appear on IRRC'S website)

(7) Type of Rulemaking (check applicable box):

- Proposed Regulation
- Final Regulation
- Final Omitted Regulation
- Emergency Certification Regulation;
 - Certification by the Governor
 - Certification by the Attorney General

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(8) Briefly explain the regulation in clear and nontechnical language. (100 words or less)

Section 62.111 implements the statutory security requirement at 66 Pa.C.S. § 2208(c)(1)(i) for licensing a retail natural gas supplier (NGS). As revised, the regulation will better balance the ability of a NGS to provide adequate security to maintain its license with the natural gas distribution company's (NGDC's) risk of financial loss in the event of supplier default. Specific revisions include: (1) the use of NGS accounts receivables in a PUC-approved purchase of receivables (POR) program to satisfy part of, or the total security requirement; (2) the adoption of standard language for financial instruments used for security when practicable; and (3) the development of reasonable criteria for use by NGDC in adjusting the security amount that a NGS must provide to maintain its license.

(9) Include a schedule for review of the regulation including:

Not applicable. See #10.

A. The date by which the agency must receive public comments: _____

B. The date or dates on which public meetings or hearings will be held: _____

C. The expected date of promulgation of the proposed regulation as a final-form regulation: _____

D. The expected effective date of the final-form regulation: _____

E. The date by which compliance with the final-form regulation will be required: _____

F. The date by which required permits, licenses or other approvals must be obtained: _____

(10) Provide the schedule for continual review of the regulation.

No schedule is needed. The regulation, when finalized, will be continually reviewed through complaints filed by NGSs against NGDCs. Such complaints would allege a failure by the NGDC to comply with the new regulation in regard to the adjustment of security amount, and the acceptance of approved types of security such as NGS accounts receivable as part of a PUC-approved POR program. The PUC will also be monitoring NGDC compliance with the regulation through its review of NGDC annual reports filed pursuant to Section 62.111(c)(5).

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SECTION II: STATEMENT OF NEED

(11) State the statutory authority for the regulation. Include specific statutory citation.

The Public Utility Code at 66 Pa.C.S. § 2203(12) and § 2208 provides that in order for a NGS to obtain or retain a NGS license it must demonstrate financial fitness by providing security to each NGDC on whose system the NGS provides retail natural gas supply service to customers. PUC regulations at Section 62.111 implement this security requirement.

(12) Is the regulation mandated by any federal or state law or court order, or federal regulation? Are there any relevant state or federal court decisions? If yes, cite the specific law, case or regulation as well as, any deadlines for action.

The regulation is not mandated by any federal law or court decision so there is no external deadline that must be met. The Public Utility Code requires that the PUC periodically review the criteria used by the NGDC to establish the amount and type of security that will be acceptable to demonstrate financial fitness of a NGS to be licensed. 66 Pa. C.S. § 2208(c). The court in *UGI Utilities, Inc. – Gas Division v. Pa. PUC*, 878 A. 2d 186 (Pa. Cmwlth. Ct. 2005) stated that the PUC has discretion to approve the criteria used to determine the amount of security that is necessary to maintain a NGS license based upon the financial impact caused on the NGDC by a defaulting NGS. The criteria, as applied, should result in a “reasonably related” financial security requirement, and not the worst case scenario, which would be contrary to the intentions of the statute to promote competition and choice in the natural gas industry.

(13) State why the regulation is needed. Explain the compelling public interest that justifies the regulation. Describe who will benefit from the regulation. Quantify the benefits as completely as possible and approximate the number of people who will benefit.

The compelling public interest advanced by this revision to the NGS licensing rules is the creation of a more competitive retail natural gas supply services market in Pennsylvania.

In its October 2005 *Report to the General Assembly on Competition in Pennsylvania’s Retail Natural Gas Market*, Docket No. I-00040103, the PUC determined that there was not effective competition in the natural gas retail market based in part on the low number of NGSs participating in the market. The amount of security that a supplier needed to be licensed as a NGS was identified as a possible barrier to market entry and participation. A collaborative of stakeholders (SEARCH) was convened to discuss ways to increase effective competition. The Staff’s Report on SEARCH posited that the use of reasonable criteria for adjusting the security amount required for supplier licensing and the possible use as security of NGS accounts receivable in POR programs could lower the market barrier and increase the number of suppliers participating in the retail market. The PUC accepted this solution in its *Final Search Order and Action Plan*, order entered September 11, 2008 at Docket No. I-00040103F0002. The revisions to Section 62.111 implement this solution.

NGSs will benefit directly from this revision as a barrier to market entry and participation will be lowered and their operational costs will decrease. Customers will also benefit as they will have more suppliers, and possibly more service options from which to choose to purchase their gas supply.

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(14) If scientific data, studies, references are used to justify this regulation, please submit material with the regulatory package. Please provide full citation and/or links to internet source.

No scientific data support is necessary for this revision to the PUC's existing NGS licensing regulations at Section 62.111.

(15) Describe who and how many will be adversely affected by the regulation. How are they affected?

No entity will be adversely affected by this revision to the NGS licensing regulation.

Pursuant to 66 Pa.C.S. § 2208(c)(1)(i), NGDCs have the authority to establish the form and amount of the security to ensure the financial responsibility of the NGS operating on the NGDC's system. This is a requirement for obtaining and maintaining a NGS license. The purpose of revising Section 62.111 was to ensure that the NGDC's establishment of, and adjustment of security amounts required for a NGS license was reasonable and nondiscriminatory.

(16) List the persons, groups or entities that will be required to comply with the regulation.

Approximate the number of people who will be required to comply.

NGDCs will be expected to comply with this regulation. There are 10 NGDCs that will need to comply with the revised regulations relating to the amount of and type of security required for a NGS to be licensed or maintain a license. There are currently 92 licensed NGSs in Pennsylvania.

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SECTION III: COST AND IMPACT ANALYSIS

(17) Provide a specific estimate of the costs and/or savings to the **regulated community** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

Section 62.111 has been revised to lower the cost of security needed for licensing by requiring that adjustments to the level of security be reasonable, and that these adjustments would occur only when necessary to cover the risk to the NGDC of supplier default. No specific estimate of savings can be developed because the savings to each NGS will vary.

As to costs, the NGDC has been administering financial security requirements for NGSs since the Natural Gas Choice and Competition Act (Chapter 22 of the Public Utility Code) went into effect in July 1, 1999. Any costs associated with implementation of the revised regulations will be incremental and cannot be specifically quantified.

(18) Provide a specific estimate of the costs and/or savings to **local governments** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

Local governments are not be affected by the revision of Section 62.111 and will not incur any costs as a result.

(19) Provide a specific estimate of the costs and/or savings to **state government** associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required. Explain how the dollar estimates were derived.

State government, including the PUC, the agency that licenses NGSs, will not incur additional costs as the result of the revision of Section 62.111. The PUC has been administering the NGS licensing process and reviewing security requirements since July 1999.

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(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	\$	\$	\$	\$	\$	\$
Regulated Community	Varies by NGS	Varies by NGS	Varies by NGS	Varies by NGS	Varies by NGS	Varies by NGS
Local Government	N/A					
State Government	N/A					
Total Savings	Cannot be quantified	Cannot be quantified	Cannot be quantified	Cannot be quantified	Cannot be quantified	Cannot be quantified
COSTS:						
Regulated Community	NGDCs Minimal	NGDCs Minimal	NGDCs Minimal	NGDCs Minimal	NGDCs Minimal	NGDCs Minimal
Local Government	N/A					
State Government	N/A					
Total Costs	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
REVENUE LOSSES:						
Regulated Community	N/A					
Local Government	N/A					
State Government	N/A					
Total Revenue Losses	N/A					

(20a) Provide the past three year expenditure history for programs affected by the regulation.

Program	FY -3	FY -2	FY -1	Current FY
Not applicable				

(21) Explain how the benefits of the regulation outweigh any cost and adverse effects.

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The purpose of revising Section 62.111 was to reform the security requirements for NGS licensing so that more suppliers will be attracted to, and will participate in the retail natural gas supply services market. The benefit created is the increase in NGSs participating in the retail market and an increase in customers drawn by the increased choice of NGSs and natural gas supply service offerings. In sum, the benefit is increased "effective competition" in Pennsylvania's retail natural gas market. The costs to the NGDCs will be minimal as they are already incurring costs for the administration of financial bonds and other securities for the NGSs that operate on their systems.

(22) Describe the communications with and input from the public and any advisory council/group in the development and drafting of the regulation. List the specific persons and/or groups who were involved.

The revisions made to Section 62.111 were based on work in two PUC proceedings. The *Report to the General Assembly on Competition In Pennsylvania's Retail Natural Gas Market*, Docket No. I-00040103 may be accessed at:
http://www.puc.state.pa.us/naturalgas/naturalgas_issues.aspx

The *Staff's Final Report on SEARCH* and the PUC's *Final SEARCH Order and Action Plan*, Docket No. I-00040103F0002 may be accessed at:
http://www.puc.state.pa.us/naturalgas/naturalgas_stakeholders_wg.aspx

Also, please see the answer to Question 13 above.

(23) Include a description of any alternative regulatory provisions which have been considered and rejected and a statement that the least burdensome acceptable alternative has been selected.

The NGS licensing regulations, including the sections relating to the security requirement, have been in effect since July 21, 2001. Pursuant to 66 Pa. C.S. § 2204(g), the PUC conducted an investigation into competition in the retail market and sponsored a collaborative of stakeholders to explore avenues to increase effective competition in the retail natural gas supply market. Changing the NGS licensing security requirement was identified as one means to increase the number of suppliers, and in turn "effective competition" in the retail market. Revising Section 62.111 to expand criteria for adjusting the security amount and the types of acceptable security for licensing purposes was least burdensome acceptable alternative to accomplish this task.

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulations.

No. There are no federal standards that govern the licensing of natural gas suppliers for Pennsylvania's retail market.

(25) How does this regulation compare with those of other states? How will this affect Pennsylvania's

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ability to compete with other states?

The impetus for the revision of the security requirement for NGS licensing was to increase the number of natural gas suppliers in Pennsylvania's retail market. By increasing the number of suppliers operating in the market, and thereby, increasing effective competition in the market, Pennsylvania should be better able to compete with other states for business development and expansion.

(26) Will the regulation affect any other regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

No other PUC regulations will be affected by the revisions made to Section 62.111.

(27) Submit a statement of legal, accounting or consulting procedures and additional reporting, recordkeeping or other paperwork, including copies of forms or reports, which will be required for implementation of the regulation and an explanation of measures which have been taken to minimize these requirements.

Each NGDC has been administering financial security requirements for licensing the NGSs since before July 1999. Section 62.111 (c)(5) adds an annual NGDC reporting requirement relating to the NGDC's administration of financial securities for NGSs, affiliated and non-affiliated, that operate on its system. This annual report will permit the PUC to monitor a NGDC's actions in establishing and adjusting security amounts to ensure that the process is reasonable and nondiscriminatory. The PUC does not anticipate that the revisions made to Section 62.111 will significantly affect the NGDC's other legal, accounting or consulting, bookkeeping or other ministerial procedures that are already in place.

(28) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

The revisions to Section 62.111 were designed to meet the identified needs of NGSs in satisfying the financial security requirement to obtain and maintain a NGS license. The regulation states that the security amount needed to be licensed must be reasonable. The regulation also sets forth criteria for establishing and adjusting security amount. As revised, the regulation expands the list of acceptable types of security to include cash, escrow accounts, NGS accounts receivables in a NGDC POR program, and "calls on capacity" or other operational offsets that may be mutually agreeable to NGDC and NGS. Additionally, Section 62.111(c)(8) lists PUC informal and formal procedures that the NGS may access to seek PUC resolution of a dispute with the NGDC over security amount.

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
(Pursuant to Commonwealth Documents Law)

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Copy below is hereby approved as to form and legality. Attorney General.

BY _____
(DEPUTY ATTORNEY GENERAL)

DATE OF APPROVAL


Check if applicable
Copy not approved. Objections attached

Copy below is hereby certified to be true and correct copy of a document issued, prescribed or promulgated by:

Pennsylvania Public Utility Commission
(AGENCY)

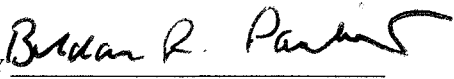
DOCUMENT/FISCAL NOTE NO. L-2008-2069115/57-266

DATE OF ADOPTION June 16, 2010

BY 
Rosemary Chiavetta

TITLE Secretary
(SECRETARY)

Copy below is hereby approved as to form and legality. Executive or independent Agencies.

BY 
Bohdan R. Pankiw
Chief Counsel

6-16-2010
DATE OF APPROVAL

Check if applicable. No Attorney General approval or objection within 30 days after submission.

L-2008-2069115/57-266
Final Rulemaking
Licensing Requirements for Natural Gas Suppliers
52 Pa. Code, Chapter 62

The Pennsylvania Public Utility Commission on June 16, 2010, adopted a final rulemaking order which revises the Commission's natural gas supplier licensing regulations regarding level of security needed and forms of security used to satisfy statutory security requirements for licensing. The contact persons are Annunciata Marino, BFUS, 772-2151 and Patricia Krise Burket, Law Bureau, 787-3464.

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held June 16, 2010

Commissioners Present:

James H. Cawley, Chairman
Tyrone J. Christy, Vice Chairman; Statement
Wayne E. Gardner
Robert F. Powelson

Licensing Requirements For Natural Gas
Suppliers; *SEARCH Final Order and Action
Plan: Natural Gas Supplier Issues*

Docket No. L-2008-2069115
I-00040103F0002

FINAL RULEMAKING ORDER

On December 8, 2008, we issued a proposed rulemaking order that set forth revisions to the security requirements for licensing natural gas suppliers at 52 Pa. Code § 62.101-62.114. In its September 11, 2008 Final Order and Action Plan regarding the Commission's *Investigation into the Natural Gas Supply Market: Report on Stakeholder's Working Group*¹, Docket No. I-00040103F0002 (*SEARCH Order*), the Commission had determined that one way to increase effective competition in the retail natural gas market was to revise the security requirements in regard to the amount of security that was needed and the types of security that could be used. Before us today is an order that finalizes the revisions to the Commission's NGS licensing regulations on these matters.

¹ The Stakeholders had been convened based on the Commission finding that "effective competition" did not exist in the retail natural gas market in accordance with 66 Pa.C.S. § 2204(g)(relating to investigation and report to General Assembly). See *Investigation into the Natural Gas Supply Market: Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market*, Order entered at Docket No. I-00040103.

DISCUSSION

Background

Section 2208(c)(1)(i) of the Public Utility Code establishes the security requirements for the issuance and maintenance of a NGS license. The section also authorizes the natural gas distribution company (NGDC) to determine the amount and form of the bond or other security that is required for a NGS license. This section reads as follows:

(c) Financial fitness.—

(1) In order to ensure the safety and reliability of the natural gas supply service in this Commonwealth, no natural gas supplier license shall be issued or remain in force unless the applicant or holder, as the case may be, complies with all of the following:

(i) Furnishes a bond or other security in a form and amount to ensure the financial responsibility of the natural gas supplier. The criteria each natural gas distribution company shall use to determine the amount and form of such bond or other security shall be set forth in the natural gas distribution company's restructuring filing. In approving the criteria, commission considerations shall include, but not be limited to, the financial impact on the natural gas distribution company or an alternative supplier of last resort of a default or subsequent bankruptcy of a natural gas supplier. The commission shall periodically review the criteria upon petition by any party. The amount and form of the bond or other security may be mutually agreed to between the natural gas distribution company or the alternate supplier of last resort and the natural gas supplier or, failing that, shall be determined by criteria approved by the commission.

66 Pa.C.S. § 2208(c)(1)(i)(emphasis added).

The Commission's NGS licensing regulations became effective on publication in the *Pennsylvania Bulletin* on July 21, 2001. 31 Pa.B. 3943. *Licensing Requirements for Natural Gas Suppliers*, Order entered April 19, 2001 at Docket No. L-00000150. Section 62.111 addresses bonds and other security. See 52 Pa. Code § 62.111.

In the *SEARCH Order*, the Commission identified NGDC security requirements as one barrier to supplier participation in the retail market². Referencing the *SEARCH Report*, the *SEARCH Order* discussed the criteria used by the NGDC in establishing a security level and the extent of the Commission's authority under the law to modify security requirements:

The criteria that are to be used by the NGDC to set the amount and form of the security were established in each company's restructuring proceeding. The level of security is based on a formula that takes into account the NGDC's exposure to costs. For the retail supply market, this formula involves the peak day demand estimate for capacity, number of days' potential exposure in a billing cycle, and commodity estimates for quantity and cost. Offsets to the amount of security that a NGS must provide may include calls on capacity, receivable purchases or receivable pledges. NGDC costs related to supplier default as set forth in Section 2207(k) of the Public Utility Code may also be taken into account when establishing the amount of security required. 66 Pa.C.S. § 2207(k). *SEARCH Report*, pp. 18-19.

If a NGDC and NGS cannot come to a mutual agreement, the level or form of security is determined by criteria approved by the Commission. *See* 66 Pa.C.S. § 2208(c)(1). These criteria were established in the Commission's NGS licensing regulations and are to be used to determine security levels and acceptable forms for the security when voluntary agreement is not reached. *See* 52 Pa. Code § 62.111. Section 62.111(c) permits the use of the irrevocable letters of credit, corporate parental or other third party guaranty, and real or personal property. Personal property would include the use of escrow account or the pledge or purchase of receivables. 52 Pa. Code § 62.111(c). *SEARCH Report*, pp. 18-19.

Also, an individual NGDC's security requirement, including the level of security, is subject to periodic review by the Commission. 66 Pa.C.S. §2208(c). *See also, UGI Utilities, Inc. – Gas Division v. PA PUC*, 878 A. 2d 186 (Pa. Cmwlth. 2005) *appeal den.* 586 Pa. 732; 890 A.2d 1062 (2005) (the Commission has discretion to approve criteria to be used to determine the financial security necessary based upon financial impact on the NGDC by a default by a NGS). Thus, a supplier is not without a remedy to address unreasonable security requirements of a NGDC on a case-by-case basis. *SEARCH Order*, pp. 23-24.

² This subject is fully discussed in the *SEARCH Report* in Section I (Creditworthiness/Security) at pp. 18-21.

The *SEARCH Order* also discussed the suppliers' position that uniformity in the use of security instruments across NGDC service territories, and greater acceptance of other types of security by the NGDCs would decrease costs for suppliers and remove a barrier to supplier entry and participation.

However, the *SEARCH Report* states that suppliers observe that the use of security instruments is not uniform among the companies and contend that this variability is a barrier to market entry and multi-system participation. Suppliers also raised concerns about the escalating cost of security to match the growth of their sales, and opined that there should be a limitation on the frequency of review of required security levels, with specific triggers for that review, such as a percentage change in pool size. *SEARCH Report*, p. 19.

Suppliers also view the NGDC's acceptance of only certain financial instruments as a barrier to market entry. Suppliers prefer to use corporate guarantees as the predominant practice. Further, to ensure fairness and remove a possible barrier for market entry, suppliers believe that specific criteria for acceptable financial instruments should be established in a regulation or order rather than permitting companies to set those through tariffs. *SEARCH Report*, p. 19.

Establishing standard language for the form of the financial instrument used for security and reasonable criteria for the amount of security should assist NGSs in obtaining security in an acceptable form and amount, while aiding the NGDC in collecting a claim against the security in the event of supplier default. North American Energy Standards Board (NAESB) forms and business practices could be reviewed for appropriateness to develop uniform language to address this issue. *SEARCH Report*, p. 21. Also, the use of a POR program should be examined as a way to reduce the level of required security, to lessen the need for frequent credit reviews and to ameliorate adjustments in security level that might normally be triggered by changes in a company's creditworthiness rating, which can occur for reasons unrelated to its immediate business interaction and relationships. *SEARCH Report*, p. 21.

SEARCH Order, pp. 24-25.

After our review of the *SEARCH Report*, we determined that it was in the public interest to initiate a rulemaking to address security requirements related to NGS licensing.” *SEARCH Order*, p. 25. Our goal was to update the security requirement in the regulations “to better balance the ability of NGS firms to provide adequate security with the NGDC’s risk of a supplier default.” Specific matters that were to be addressed included: (1) the use of NGS accounts receivable in purchase of receivables programs as fulfillment of some part, 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. *SEARCH Order*, p. 26.

The proposed rulemaking order was entered on December 8, 2008, and was published on April 4, 2009, in the *Pennsylvania Bulletin* at 39 Pa.B. 1657. The order established a 60-day comment period. No reply comments were permitted to be filed.

Comments were filed by seven interested parties: the Energy Association of Pennsylvania (EAPA)³; the NGS Parties⁴, the Retail Energy Supply Association (RESA)⁵; Philadelphia Gas Works (PGW); National Fuel Gas Distribution Company (NFG); PECO Energy Company (PECO) and Equitable Gas Company (Equitable). The Independent Regulatory Review Commission (IRRC) also filed comments.

³ Natural gas industry members of EAPA include Columbia Gas of PA, Dominion Peoples, Equitable Gas, National Fuel Gas Distribution Corp., PECO Energy Co., Philadelphia Gas Works, and UGI Utilities, Inc.

⁴ The NGS Parties include Agway Energy Services, LLC, Gateway Energy Services Corporation, Interstate Gas Supply, Inc., and Vectren Retail, LLC.

⁵ RESA is a non-profit trade association whose members are involved in the wholesale generation of electric generation and the competitive supply of natural gas to residential, commercial and industrial customers. 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 Corporation, RRI Energy, Sempra Energy Solutions LLC, SUEZ Energy Resources NA, Inc., and US Energy Savings Corporation.

We have reviewed and addressed these comments below.

Comments

§ 62.111 – Suppliers Serving Large Customers (over 300 Mcf annually)

As a general comment, Equitable states that modifications to Section 62.111 should make it clear that the security provisions apply only to those natural gas suppliers who offer service to residential customers and small commercial and industrial customers that consume less than 300 Mcf annually. Equitable also expresses the opinion that a NGS that offers service to large commercial and industrial customers should be permitted and required to determine appropriate security with the NGDC outside the parameters of this section. *Equitable Comments*, Appendix A, p. 1.

Resolution

The definition of “natural gas supplier” at 66 Pa.C.S. § 2202 does not categorize a supplier by the class of customers it serves, nor by the volume of natural gas its customers consume. In fact, the only criterion in the definition is that the natural gas supplier provides retail natural gas supply service as opposed to wholesale gas service. For this reason, we see no need to make a distinction between suppliers based on the volume of gas that customers consume, especially since we are attempting to create a more competitive retail market by adopting consistent requirements for suppliers. Accordingly, we will not make the requested change.

As to Equitable’s comment that it should be able to determine appropriate security for a NGS that offers service to large commercial and industrial customers outside the parameters of this section, we will note that a NGDC and a supplier can always come to a

mutual agreement on the amount of security that the NGS must provide. 66 Pa. C.S. § 2208(C)(1)(i)(relating to requirements for natural gas suppliers; financial fitness). The only caveat is that the NGDC must apply the criteria used as the basis for such an agreement to other agreements with other similarly situated suppliers so as to avoid discriminatory or anticompetitive conduct. See 66 Pa.C.S. § 2209 (relating to market power remediation); 52 Pa. Code § 62.141 - § 62.142 (relating to standards of conduct).

Section 62.111(c)(1)(i) - Security Amount

RESA proposes the addition to the regulation of a formula that would be used to calculate the amount of security that will be required to operate on a NGDC's system. The formula is that "security cannot exceed the NGS' customers' MDQ [Maximum Daily Quantity] times the peak forecasted NYMEX [New York Mercantile Exchange] price for the next 12 months and for upstream capacity to the city gate times 10 days." *RESA Comments*, p. 4.

RESA also suggests a baseline creditworthiness standard, which if met, would satisfy the Section 2208(c) security requirement and would obviate the need for the supplier to post additional security. The standard would entail the supplier having a minimum investment grade credit rating or its equivalent from two of three credit rating agencies. *RESA Comments*, pp. 5-6. RESA states that the minimum threshold security requirement is warranted to reflect the reduced risk associated with a NGS that has a favorable investment grade/credit rating. *RESA Comments*, p. 7.

EAPA comments that financial security requirements for NGSs are necessitated by Section 2207(k) that permits the NGDC, acting as the supplier of last resort (SOLR), to charge customers returning from a defaulting supplier the rates the supplier would have charged the customer for the remainder of the billing cycle. 66 Pa.C.S. § 2207 (k)

(relating to rate after service discontinued [by a defaulting supplier]). *EAPA Comments*, pp. 1-2. This section specifically provides that:

any difference between costs incurred by the supplier of last resort and the amounts payable by the retail gas customer shall be recovered from the natural gas supplier or from the bond or other security provided by the natural gas supplier without recourse to any retail gas customer not otherwise contractually committed for the difference.

66 Pa.C.S. § 2207(k).

The supplier's bond or other security pays the NGDC or the SOLR the difference between the cost of the replacement gas supply for returning customers from a defaulting supplier and the amount that the NGDC or SOLR can collect from those customers for the gas supply under the defaulting supplier's agreement.

EAPA also comments that financial risks imposed by Section 2207(k) vary from NGDC to NGDC. For NGDCs that have on-system storage facilities, native natural gas production and ample pipeline capacity, the financial risk of obtaining supply during peak periods may be relatively small. *EAPA Comments*, p. 2. For those NGDCs who do not, the financial risks may be relatively large. The bond or other security provided by the NGS ensures the financial responsibility of the supplier, but ultimately ensures "the safety and the reliability of the natural gas supply service in this Commonwealth." See 66 Pa.C.S. § 2208(c)(1)(i). *EAPA Comments*, p. 2.

Resolution

Section 2208 (c)(1) requires that a supplier provide a bond or other security to ensure its financial responsibility so it can be licensed as a NGS. 66 Pa.C.S.

§ 2208(c)(1). The purpose of the security is to ensure the financial responsibility of the supplier and the safety and the reliability of the natural gas supply. 66 Pa.C.S.

§2208(c)(1). Specifically, the security can be used to pay, in part, for the costs of replacement gas supply for customers of suppliers who return to default service.

Section 62.111(c)(1) has always recognized that the starting point for setting the security for a licensee was the amount that would satisfy the statutory requirement in 66 Pa. C.S. § 2207(K). Section 62.111(c)(1) reads as follows:

(1) The amount of the security should be reasonably related to the financial exposure imposed on the NGDC or supplier of last resort resulting from the default or bankruptcy of the licensee. At a minimum, 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.

52 Pa. Code § 62.111(c)(1).

This preliminary security amount could then be adjusted upward or downward based on the criteria set forth in Section 62.111(c)(1)(i)(A)-(E).

In reviewing the comments to this rulemaking, we discovered that the use of the phrase "at minimum" in the second sentence as well as the paraphrasing of statutory language from Section 2207(k) has created some confusion. For this reason, we will revise this sentence by deleting the phrase "at minimum" and the word "material," and by incorporating the exact statutory language from Section 2207(k). This revision should make the method for establishing the preliminary security amount required for licensing more understandable. This amount will then be the security amount ordinarily required, unless one or more of the criteria set forth in Section 62.111(c)(1)(i)(A)-(E) warrant an upward or downward adjustment to that amount.

While we agree that a NGS's credit rating may be taken into account by an NGDC in establishing the amount of security, we cannot adopt RESA's proposal to eliminate the security requirement upon the showing of some baseline creditworthiness standard. Risks vary from supplier to supplier, and thus, financial exposure posed by suppliers operating on NGDC systems vary from NGDC to NGDC making a baseline creditworthiness standard based solely on credit or investment ratings difficult, if not impossible, to establish for use in the statewide retail market. However, we understand

that some NGDCs do not require a NGS to post additional security when the NGS has a high credit rating, or is backed by a highly rated parental or other corporate guaranty. To the extent that a NGDC has adopted such a standard, we will direct that the NGDC include this standard in its tariff. This will ensure that all NGSs have notice of the standard and will further ensure that the standard is applied in a non-discriminatory manner to all NGSs. We have also revised Section 62.111(c) to require NGDCs to include this information in their tariffs.

In regard to the RESA's suggestion to use a standardized formula to calculate the security amount, the law provides NGDCs with the discretion to set the security amount for licensing, and states that the criteria used "shall include, but not be limited to, the financial impact on the natural gas distribution company . . . of a default or subsequent bankruptcy of a natural gas supplier." 66 Pa.C.S. § 2208(c)(1)(i). Because the NGDC may take into account criteria other than the cost of replacement gas when establishing a security amount for a supplier, we do not believe that it appropriate to adopt one standard formula to calculate the security amount for use by all NGDCs. Accordingly, we will not adopt RESA revision to the regulations at this time.

We note, however, that some NGDCs may use their own formulas to calculate the level of security for NGSs operating on their systems. These formulas were established in the NGDCs' restructuring proceedings for the retail supply market. These formulas involve the peak day demand estimate for capacity, the number of days potential exposure in the billing cycle and the commodity estimates for quantity and cost. *SEARCH Report*, p. 18-19. Again, to promote transparency of credit requirements for licensing, we will direct a NGDC that uses a formula to calculate security amounts to include the formula with other applicable rules for its use in its tariff. We have also revised Section 62.111(c) to require NGDCs to include this information in their tariffs.

While the NGDC has the discretion to set the level of security, the Commission has the authority to approve criteria to be used to determine the appropriate amount of security based upon financial impact on the NGDC of a supplier's default, and may review NGDC decisions regarding the application of these criteria. Nevertheless, we expect that the NGDC will establish a security amount that is reasonably related to its financial exposure. *See UGI Utilities v. Pennsylvania Public Utility Commission*, 878 A.2d 186, 192 (Pa. Cmwlth. 2005)(*UGI Utilities*) (the law provides for a "reasonably related" financial security requirement, not the worst case scenario as determined by the NGDC, which is contrary to the intentions of the statute to promote competition and choice in the natural gas industry).

However, when a NGS believes that the amount of security that it is being required to post to obtain a license is too high and it cannot come to an agreement with the NGDC regarding an alternative amount, it may file a formal complaint against a NGDC. The Commission has adjudicated complaints from suppliers against NGDCs alleging high security amounts, and, based on the record presented, has adjusted security when it was warranted. *See UGI Utilities, supra*. Alternatively, a supplier may follow the procedures to dispute a NGDC's determination of the security amount set forth in Section 62.111(c) (8)(i) and (ii) that are discussed below.

Section 62.111 (c)(1)(ii) - Adjustment of Security Amount

Section 62.111(c)(1)(ii) states that the amount of the security may be adjusted, but not more often than every six months, and the adjustments must be reasonable. It then lists criteria upon which these adjustments must be based. In response to suppliers' complaints about the frequency of security level adjustments and the need for specific triggering events for creditworthiness reviews and security adjustments, we proposed to revise the criteria to make them more stringent. The regulation was revised so that only changes in the NGS's operation that would *materially* affect the NGDC system operation

or reliability or changes that would *materially* affect the NGS's creditworthiness could trigger a review and adjustment of security.

We have divided the comments filed to this section into two parts to facilitate their disposition.

A. Six Month Time Restriction

EAPA and NFG propose eliminating the six months limit on adjusting security and recommends reliance on reasonableness of the requirement to protect against rapid and random changes in security. The argument is that allowing changes more frequently than every 6 months will permit the NGS to maintain different security levels in the winter and the summer because the NGDC will no longer fear being locked into a security amount in the event of a change in circumstances. This would not be a burden to the NGSs and would provide greater flexibility for both parties. As an alternative, NFG suggests a limit or freeze on NGS customer enrollments. *EAPA Comments*, p. 3; *NFG Comments*, p. 5.

Resolution

The Commission understands the utility of eliminating the six months restriction on adjusting security amounts and will delete it from Section 62.111(c)(1)(ii). We believe that elimination of this restriction will allow the NGDC to establish reasonable levels of security for NGSs operating on its system. We will substitute the phrase "as circumstances warrant" for the deleted language.

B. Triggering Events for Adjustment in Security Amount; Adjustments in Advance of Possible Default; Need to Define Modifiers “Significant” and “Materially” for Clarity

The EAPA offers revisions to the proposed regulation to achieve two purposes: (1) to ensure that security is provided in advance of supplier default that it is sufficient to cover the financial risk to the NGDC; and (2) to allow for adjustment of the security amount when there is a significant increase in customer number, change in class of customer served or significant change in the volume of gas supplied by the NGS.

PGW states that security levels should be adjusted when there is a significant change in volume of gas provided by the supplier. This change in volume would be independent of an increase in the number of customers since a current commercial or industrial customer could significantly increase its purchase of gas from a supplier and thus significantly increase the financial exposure of PGW and its customers. PGW and Equitable suggest that a 10% increase in volume would represent a significant increase in volume that would justify an adjustment in the amount of security. NFG and Equitable agree that an increase in gas volume may be more important than an increase in the number of customers. NFG also suggests that the Commission should evaluate a means of tying the ability to adjust security requirements to commodity prices. *Equitable Comments*, Appendix A, p. 1; *NFG Comments*, p. 3. PECO supports a threshold of a 25% increase in the projected quantity of natural gas that suppliers deliver or an increase in the projected volume of gas consumed to trigger an increase in security requirements. *PECO Comments*, pp. 2-3.

The EAPA states that the “25% change in customers” trigger for adjustment of security amount is arbitrary and does not consider a change in the volume of natural gas supplied. If the parties cannot agree on the meaning of the term “significant,” the proposed Section 62.111(c)(6) provides a means to resolve the dispute. Thus,

prescriptive triggers can be avoided and the final sentence of the proposed regulation at §62.111(c)(i)(ii)(C) can be deleted. *EAPA Comments*, p. 3.

IRRC states that this provision should be revised to reflect the impact on the NGDC's financial risk of changes in volume delivered or consumed as well as changes in the number of customers. IRRC also states that the PUC should specify the percentage change in volume that could trigger an adjustment to the amount of security required. *IRRC Comments*, p. 2.

In regard to timing, NFG states that directing a change in security only if an event materially affects system operations or reliability potentially subjects all customers to unnecessary risk that could have been avoided if a NGS was required to post appropriate security before it *materially* impacted system operations. In other words, NFG believes it is appropriate to have sufficient security to cover *material* impacts on the system operations before, and not after, the event occurs. In addition, NFG states that an early warning of a supplier's default could be discerned from a pattern of operating violations that may not, at the time, have been material. *NFG Comments*, pp. 2-3.

PGW recommends that the criteria that would trigger an adjustment in the level of security for a NGS should be expanded to include "significant changes in a licensee's recent operating history that materially affected NGDC system operations or reliability on other NGDC systems." *PGW Comments*, pp. 2-3.

NFG objects to the use of the phrases "significant changes" and "materially affects" because they are too broad and ambiguous for a regulations. NFG also characterizes the "materiality" clause (as affecting system reliability) as a loophole that would only benefit potentially unreliable NGSs. *NFG Comments*, pp. 3-4. NFG recommends deletion of this language.

IRRC states that “significant changes” should be defined or clearly explained in Section 62.111(c)(1)(ii)(A) and (B). IRRC also states that the term “material affects” in Section 62.111(c)(1)(ii)(A), (B) and (E) should be defined in each instance or include the criteria that are to be used in each instance to determine if there is a material effect.

IRRC’s Comments, p. 1.

Resolution

In regard to circumstances that may warrant a change in the level of security, we agree that a substantial change in volume of gas sold by a supplier could warrant an adjustment of the security amount, and so we will revise Section 62.111(c)(1)(i)(C) to add “change in volume of gas” as a triggering event for adjusting security amounts.

However, security adjustments for changes in the price of natural gas require more careful consideration. We can foresee that price volatility could cause a NGDC to request an ever escalating amount of security for a short term period. The NGS would then be obliged to request a change in security when prices fell. Accordingly, we will add a provision that a 25% change in the unit price of gas averaged over a consecutive 30 day period will constitute a significant change in price that would support a change in security level.

In regard to the percentage change in the number of customers served, we will follow IRRC’s comment and better define the changes that may be considered to be a significant change that could trigger a change in security levels. Specifically, we have revised Section 62.111(c)(1)(ii)(C) to add a time element so that a significant change in customer number would be a change of 25% averaged over a consecutive 30 day period. We have added this same qualification to better define a change in volume of gas delivered that could trigger a change in security amount. We note that a 25% benchmark may appear to be overly generous, but it cuts both ways. Just as a 25% increase in

customers would act as a triggering event that would allow a NGDC to increase a NGS's security amount, a 25% decrease in customers would act as an event that would allow a supplier to request a decrease in security amount.

We have revised the following sections to add language that explain circumstances relating to credit rating services and investment rating services that could materially affect a licensee's creditworthiness:

- Section 62.111(c)(1)(ii)(B) - when two of five listed credit rating companies change the licensee's credit rating.
- Section 62.111(c)(1)(ii)(D) – when a two of the five listed investment ratings service change the licensee's ratings of its issued securities.

As now revised, Section 62.111(c)(1)(ii)(B) would be applicable to a supplier's credit score for obtaining a bond or letter of credit from an insurance company or bank or other surety. Section 62.111(c)(1)(ii)(D), as now revised, may be most applicable to situations where the NGDC has agreed to to accept a corporate, parental or other third-party guaranty as security. *See* Section 62.111(c)(2)(iii). To ensure that a supplier's change in rating was not a mistake or fluke, we added the requirement that two of the five listed major ratings companies would need to make the change in rating to trigger an adjustment in the security amount.

In response to IRRC's comment, we have also revised Section 62.111(c)(2)(ii)(E) to explain that a NGDC system's operation or reliability could be materially impacted when a supplier fails to deliver natural gas supply sufficient to meet its customers' needs on five separate occasions within a 30 day period, or fails to comply with NGDC operational flow orders as defined at 52 Pa. Code § 69.11(relating to definitions). These are only two examples of how a NGDC could be impacted when a supplier defaults on gas delivery volumes.

In regard to the comments that urge that changes in a NGS's operating history on other NGDC systems that materially affect system operation and reliability should also be considered as a basis for adjusting the security amount, we agree. A record of a NGS's compliance with other NGDC system requirements is a fair predictor of its future compliance with another NGDC's system requirements. For this reason, we believe that the operating history of an applicant or a licensee on other NGDC systems may also be considered by a NGDC when it establishes the initial security amount necessary for the applicant to be licensed as a NGS in Pennsylvania. Accordingly, we have revised both Section 62.111(c)(1)(i)(A) and 62.111(c)(1)(ii)(A) consistent with this discussion.

Finally, for consistency, we added a reference to Section 62.111(c)(i)(A)-(E), as now revised, in Section 62.111(c)(1)(i)(D) to better explain the phrase "information that materially affects a licensee's creditworthiness" in regard to establishing the initial security amount for NGS licensing requirement.

Section 62.111(c)(2) -Types of Security

This section lists the legal and financial instruments that shall be acceptable for security. In the proposed rulemaking order, we revised the list to include escrow accounts, accounts pledged to the NGDC or sold by the supplier in a NGDC purchase of receivables program, and "calls on capacity" or other operational offsets that may be mutually agreeable to NGDC and NGS.

In its comments, NFG argues that accounts receivable that are 'sold' cannot be used as security by anyone. NFG states that the financial exposure imposed by an NGS on a NGDC may be reduced by a purchase of receivables program. The accounts receivable will not be a security instrument, but it will lower the financial exposure of the NGDC through the ability of the NGDC to "off-set" any potential liabilities incurred by the NGS with payments due under the POR. *NFG Comments*, pp. 5-6.

Equitable states that the final regulations for POR programs have not yet been established so it is premature to include receivables as a type of acceptable security. Currently Equitable forwards NGS receivables once per calendar month. Equitable questions whether it would be acceptable for the NGDC to retain 100% of the NGS receivables if the NGS fails to deliver gas during a winter month. Equitable also states that a NGDC should be allowed to retain 100% of NGS receivables in the event of a mid-month NGS failure to deliver, and receivables considered to be acceptable security. The receivables would be used to satisfy the NGS obligations with the balance, if any, payable to the NGS. Equitable notes that NGSs have historically failed during periods of a run-up in gas prices. *Equitable Comments*, Appendix A, pp. 1-2.

PECO states that if a NGDC purchases NGS customer receivables, the receivables belong to the NGDC and the NGDC acquires the increased risk of uncollectible accounts. NGDCs should not be required to use those receivables to satisfy NGS security requirements. *PECO Comments*, p. 4.

IRRC states that the PUC needs to provide further justification for including accounts receivable as acceptable security. This direction is based on comments that receivables cannot quickly be converted to cash, and alone, should not be an acceptable form of security. *IRRC Comments*, p. 2.

RESA suggests adding an additional operational offset to be used as security in Section 62.111(c)(2)(vi): “netting NGDC gas supply purchases against NGS collateral requirements.” *RESA Comments*, p. 7.

NFG comments that “cash” should be added as a form of security. NFG also comments that “escrow accounts” should be deleted as a type of security because of the administrative expenses involved in maintaining such an account. *NFG Comments*, p. 5.

Resolution

The use of the word “sold” in the provision that permitted purchase of receivables to be used as security collateral was to provide flexibility to NGDCs in designing “purchase of receivables” programs (POR). Because of the legal ambiguity unintentionally created, we have replaced the word “sold” with “assigned.”

In response to IRRC’s comment regarding the need to justify the use of receivables as a security, we note that accounts receivable represent a future stream of income owed to the NGS, and thus, are an asset. As such, receivables are NGS personal property, a type of security that has been recognized as an acceptable form of security since the regulations were first promulgated on July 21, 2001. *See* 52 Pa. Code § 62.111(c)(3); 31 Pa.B. 3943. By way of further explanation, in POR programs NGS receivables are pledged or are assigned to the NGDC, thereby transferring an asset to the NGDC which, in turn, reduces the financial risk to the NGDC in the event of a NGS default on its obligations, *e.g.*, failure to deliver gas in the necessary quantities. The discounting of NGS receivables in a NGDC’s POR accounts for the risk of uncollectibles, and reduces the NGDC’s overall financial exposure by improving the quality of those NGS accounts receivable which now belong to the NGDC. For these reasons, we believe that receivables in a POR program are an acceptable form of security. We will also adopt RESA’s suggestion and will add the “netting” of “NGDC gas supply purchases from the NGS” against “NGS security requirements” as another example of an operational offset that is acceptable as security in Section 62.111(c)(2)(vi).

In addition, we will clarify that NGS receivables in a POR program, or any of the other financial or legal instruments or property, real or personal, listed as acceptable forms of security in Section 62.111(c)(2) need not by itself satisfy the entire security

amount. The NGS may offer to provide one or more these forms of security to satisfy the total security amount required for licensing.

We will also revise this section to add “cash” as an acceptable type of security at Section 62.111(c)(2)(vii). However, we will not eliminate the use of “escrow accounts” as suggested by NFG. We understand that there may be additional costs involved with maintaining an escrow account, but if the NGDC and NGS are both agreeable to its use, responsibility for the maintenance cost is just another point for agreement.

Ideally, the NGS and the NDC will come to an agreement on the amount and the form of security that the NGS will need to provide to maintain its license. However, the NGDC’s determinations in regard to the security amount or the forms of security it will accept is subject to Commission review and must be reasonable in regard to the individual supplier and consistent in regard to all suppliers to guard against discriminatory or anti-competitive conduct. *See* 52 Pa. Code § 62.111(c).

Section 62.111(c)(4) - Use of NAESB Standards

This proposed section states that, when practicable, the NGDC shall use applicable North American Energy Standards Board (NAESB) forms or language for financial and legal instruments.

In its comments, Equitable believes that the use of forms and language in security instruments should also be at the discretion of the NGDC and proposes the following language:

When practicable and in the NGDC’s discretion, the NGDC shall use applicable North American Energy Standards Board forms or language for financial and legal instruments that are used for security.

In regard to Section 62.111(c)(4), Equitable states that the use of forms and language in security instruments should be at the discretion of the NGDC. *Equitable Comments*, Appendix A, p. 2.

Resolution

The Commission declines to revise this section. The standardization of business practices, including forms, was identified as a means to increase supplier participation in the statewide retail natural gas supply market. *SEARCH Order*, pp. 26-33. NAESB has developed numerous forms that are in use in the natural gas industry today. While NAESB business practices, forms and language for financial and legal instruments will be examined more thoroughly in the rulemaking, *Natural Gas Distribution Company Business Practices*, Order entered May 1, 2009 at Docket No. L-2008-2069117, we see no reason not to encourage their use, where practical, here.

Section 62.111(c)(5) – Annual Reporting Requirements

Proposed Section 62.111(c)(5) imposes an annual reporting requirement on the NGDCs. The purpose of this reporting requirement is to gather information about the NGDC's application of established criteria to set and adjust levels of security for suppliers that operate on the NGDC's system. The report will be filed with the Commission's Secretary.

PGW comments that Section 62.111(c)(5)(iv), which requires that the NGDC report "the number of times in the last quarter that the NGDC determined that a change in the level of security was needed for a supplier to maintain its license," should be changed to the number of times in the last year. *PGW Comments*, p. 5. EAPA provided the same comment. *EAPA Comments*, p. 4.

In its comments, EAPA offers revisions to streamline and consolidate the new reporting requirements and clarifies that it is not the NGDC, but the Commission who grants the license. EAPA states that its revisions underscore that the amount and form of the security should be reasonably related to the financial exposure imposed on the NGDC or SOLR resulting from a potential default or bankruptcy of the NGS. The criteria established for security must “ensure the financial responsibility” of the licensee in the event of default or bankruptcy, and EAPA’s proposed revisions use that specific wording. *EAPA Comments*, p. 4.

Resolution

The Commission has proposed an annual reporting requirement to gather information about the criteria used by NGDCs to establish security amounts and the rules used by NGDCs to adjust security amounts to obtain, and maintain a NGS license. *See* 52 Pa. Code § 62.111 (c)(5). The information collected will be used to study the criteria and rules used by the NGDCs to establish and adjust security amounts for NGSs operating on their systems. The data will also be used to evaluate the consistency of the application by a NGDC of its criteria and rules to NGSs operating on its system. It is envisioned that the collected data may also be used to standardize these criteria and rules so that they may be included for use by all NGDCs in a standardized supplier coordination tariff.

Based on the comments, we have revised the reporting requirements to clarify that it is the Commission and not the NGDC that grants an NGS a license. While Section 62.111 (b) makes it clear that the purpose of the security requirement for licensing is to ensure the licensee’s financial responsibility, we have added EAPA’s suggested language that reiterates this point in regard to security that the licensee must have in place to maintain its license in Section 62.111(c)(5)(ii). We also revised Section 62.111(c)(5)(iv)

to delete language that requests data be reported “for the last quarter” as being inconsistent with an annual reporting requirement.

Section 62.111(c)(6)- Dispute Resolution Procedures

Proposed Section 62.111(c)(6) lists four Commission processes that a NGS may pursue if it is unable to reach an agreement with the NGDC on the form or amount of security to be provided: informal mediation; alternate dispute resolution with the OALJ; litigation of a formal complaint; and petition for Commission review of NGDC criteria for security levels. The first alternative presented, informal mediation, may be requested by filing a dispute with the Commission’s Secretary. The Secretary will assign the complaint to the appropriate bureau that will act as the mediator between the NGS and the NGDC.

In its comments, RESA suggests that the Commission add a provision that lists the Commission processes, formal and informal that a NGS may pursue to resolve a dispute with the NGDC on the form and/ or amount of security. *RESA Comments*, p. 9.

NFG states that there is no mention of the Office of Competitive Market Oversight⁶ in the dispute resolution section and states that attempting to resolve the dispute through the OCMO should be required before an NGS can attempt to obtain other Commission intervention by filing a formal complaint. *NFG Comments*, p. 6. PECO comments that supplier complaints should be initially referred to the OCMO for mediation and advisory purposes. *PECO Comments*, p. 5.

⁶ In the SEARCH Action Plan, the Commission directed that an independent unit be created within the Commission to oversee the development and the functioning of the competitive retail natural gas market. *SEARCH Order*, pp. 8-10 and Ordering Paragraph 5. The unit, the Office of Competitive Market Supply, was created within the Office of the Director of Operations by Secretarial Letter dated January 9, 2009 at Docket No. M-2009-2082042.

NFG also states that the section does not explain how the financial security should be handled pending the resolution of the dispute. NFG suggests that in order to protect system reliability and NGDC ratepayers, an NGS must post the required security in order to provide or continue to provide service on the NGDC system pending the dispute resolution. *NFG Comments*, p. 7. PECO comments that the Commission should clarify its intent that NGSs continue to provide service to customers during disputes. *PECO Comments*, p. 5.

Equitable states that the NGDC should have the right of appeal to the Commission from a bureau decision concerning NGS security. *Equitable Comments*, Appendix A. p. 3. EAPA supports the dispute resolution provision and suggests revising it to require the NGS first to attempt to resolve the issue with the NGDC: to assign the dispute to the OCMO; and to require an existing licensee to post the adjusted security amount requested by the NGDC until the dispute is resolved. The rationale is to ensure that there is adequate security in place to cover the financial exposure of the NGDC while the dispute is being resolved. *EAPA Comments*, p. 5.

IRRC states that several commenters noted that the regulation does not address the NGS's responsibilities to customers during the dispute resolution process. IRRC suggests that, in the final form regulation, the Commission should clarify the responsibilities of all parties during the pendency of the dispute. *IRRC Comments*, p. 2.

Resolution

We have not identified the Office of Competitive Market Office as the Commission office that will mediate a dispute about the amount of security because we did not want to limit our ability in making such assignments. In Section 62.111(c)(8)(1), we did expand the list of bureaus that will be involved in informal mediation to include

an “office, or other designated unit.” The term “other designated unit” is intended to include working groups composed of staff and other stakeholders.

We have included a requirement that the NGS must contact the NGDC and attempt to resolve the dispute over the security amount before filing for Commission intervention through informal mediation, alternative dispute resolution or litigation. We agree that the parties should make an initial attempt to resolve the differences between themselves. However, we do not see the necessity of requiring an existing licensee to go through an informal mediation process before it may file a formal complaint with the Commission. Accordingly, we will not adopt this suggestion.

We also will not adopt the suggestion that we provide for a right of appeal to the Commission from a bureau decision concerning NGS security because it is unnecessary. Section 5.44 of the Commission’s Rules of Practice and Procedure already permits a party to appeal the decision of Commission staff. *See* 52 Pa. Code § 5.44 (relating to petitions for appeal from actions of the staff).

In response to IRRC’s comment, we have added Section 62.111(c)(9) that clarifies the responsibilities of the NGS and the NGDC to all parties, including customers, during the pendency of a dispute, including the requirement that the NGS post the amount of security requested by the NGDC. The Commission notes that it expects that the security amount requested by the NGDC will be a good faith estimate necessary to ensure the financial responsibility of the supplier as this amount may be subject to change or refund depending on the ultimate resolution of the dispute.

Section 62.111(c)(7) - NGS Request for Change in Security

RESA states that the NGDCs should be permitted to request a peak (winter) and 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 New York's Uniform Business Practices, would calculate security based on the 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. *RESA Comments*, p. 4.

RESA also requests the addition of a provision that permits a NGS to request a reduction in security upon certain conditions including a rating upgrade to the minimal rating level of two of the three following agencies: Standard and Poor's Rating Services, Moody's Investor Service, Inc. and Fitch, Inc., or a significant decrease in the total usage of the supplier's customers for 30 days; or a significant decrease in gas supply cost lasting for 30 days. RESA further proposes that a significant reduction be defined as a reduction of 25% in total customer load or in gas supply costs. This addition would further reduce market entry barriers for suppliers and ensure broader participation by existing suppliers. *RESA Comments*, p. 6.

IRRC suggests that the regulation permit suppliers to request a reduction in security under certain circumstances where it is apparent that there is a reduction in the risk of supplier default. IRRC states that RESA recommends that specific criteria be used in demonstrating the reduction of risk and a 5-calendar day time limit within which the NGDC must make its decision. IRRC questions if there is an existing process by which the supplier can seek decreased security requirements. If there is a process, then it should be included in this regulation. If there is no process in place, the Commission should consider including one in the final form regulations. *IRRC Comments*, p. 1.

Resolution

The Commission first notes that the elimination of the 6 month restriction on adjusting security amounts in Section 62.111(c) (1)(ii) should facilitate seasonal levels of bonding, and permit a supplier to ask for reduction in security when the risk of financial exposure to the NGDC decreases.

The Commission has provided criteria for the adjustment of security in Section 62.111(c) (1)(ii)(A)-(E) that may be used by the NGDC to increase the security amount when financial risk to the NGDC is increased, and by the NGS to request a reduction in security amount when the financial risk to the NGDC decreases. Section 62.111(c)(7) sets forth an procedure, including specific deadlines for response, that may be used by the NGS to request a decrease in security amount when the NGS is unable to come to agreement with a NGDC for a lower security amount. We believe that these revisions are consistent with and satisfy RESA's and IRRC's comments on this issue.

CONCLUSION

The Commission adopts the regulation revised herein as final. This rulemaking revises Section 62.111 to include, *inter alia*, the development of reasonable criteria for establishing the initial security amount and for adjusting the security amount for a NGS license, regardless of whether the request for the adjustment is made by the NGDC or the NGS. Also established is a NGDC annual reporting requirement that will permit the Commission to collect data relating to the adjustment of security amounts and the triggering events, financial and/or operational, that triggered the adjustment. The revision also permits the use of escrow accounts, cash, and NGS accounts receivable in a Commission-approved POR program to reduce the total security requirement. Finally, Section 62.111(c)(7) establishes a process by which a supplier can request a reduction in security

amount, and Section 62.111(c)(8) sets forth an informal procedure that may be used by the NGS in lieu of filing a formal complaint to resolve a dispute with a NGDC over the amount of security required for licensing. The Commission believes that these regulations, as revised, better balance the ability of a NGS to provide adequate security to maintain its license with a NGDC's actual risk of financial loss in the event of supplier default.

Accordingly, pursuant to Sections 501, 2203(12) and 2208 of the Public Utility Code, 66 Pa.C.S. §§ 501, 2203 and 2208; Sections 201 and 202 of the Act of July 31, 1968, P.L. 769 No. 240, 45 P.S. §§ 1201-1202, and the regulations promulgated thereunder at 1 Pa. Code §§ 7.1, 7.2, and 7.5; Section 204(b) of the Commonwealth Attorneys Act, 71 P.S. § 732.204(b); Section 745.5 of the Regulatory Review Act, 71 P.S. § 745.5; and Section 612 of the Administrative Code of 1929, 71 P.S. § 232, and the regulations promulgated thereunder at 4 Pa. Code §§ 7.231-7.234, we will adopt as final the proposed revisions to Section 62.111 as set forth in Annex A, attached hereto;

THEREFORE,

IT IS ORDERED:

1. That the regulation of the Commission, 52 Pa. Code § 62.111 (relating to bonds or other security [for natural gas supplier licenses]) is amended to read as set forth in Annex A.
2. That the Secretary shall submit this order and Annex A to the Office of Attorney General for approval as to legality.
3. That the Secretary shall submit this order and Annex A to the Governor's Budget Office for review of fiscal impact.

4. That the Secretary shall submit this order and Annex A for review by the designated standing committees of both houses of the General Assembly, and for review and approval by the Independent Regulatory Review Commission.

5. That the Secretary shall duly certify this order and Annex A with the Legislative Reference Bureau for publication in the *Pennsylvania Bulletin*.

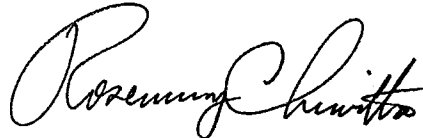
6. That these regulations shall become effective upon publication in the *Pennsylvania Bulletin*.

7. That the contact persons for this final-form rulemaking are Annunciata Marino, FUS, (717) 772-2151 (technical), Patricia Krise Burket, Assistant Counsel, (717) 787-3464. Alternate formats of this document are available to persons with disabilities and may be obtained by contacting Sherri DelBiondo, Regulatory Review Assistant, Law Bureau, (717) 772-4597.

8. That a copy of this Order and Annex A shall be served on all jurisdictional natural gas distribution companies, natural gas suppliers, the Office of Consumer Advocate, the Office of Small Business Advocate and all other parties that filed comments at Docket No. L-2008-2069115, Licensing Requirements for Natural Gas Suppliers.

9. That within 30 days after the date that these regulations become effective, all natural gas distribution companies shall file with the Commission's Secretary revised tariff pages consistent with this order and these regulations. The natural gas distribution company shall serve a copy of this compliance filing on all natural gas suppliers licensed in its service territory.

BY THE COMMISSION,

A handwritten signature in black ink, appearing to read "Rosemary Chiavetta". The signature is fluid and cursive, with the first letter of each name being significantly larger and more stylized.

Rosemary Chiavetta
Secretary

(SEAL)

ORDER ADOPTED: June 16, 2010

ORDER ENTERED: **June 17, 2010**

ANNEX A

PART I. PUBLIC UTILITY COMMISSION
Subpart C. FIXED SERVICE UTILITIES
CHAPTER 62. NATURAL GAS SUPPLY CUSTOMER CHOICE
Subchapter D. LICENSING REQUIREMENTS FOR NATURAL GAS
SUPPLIERS

* * * *

§ 62.111. Bonds or other security.

(a) A license will not be issued or remain in force until the licensee furnishes proof of a bond or other security. See section 2208(c)(1)(i) of the act (relating to requirements for natural gas suppliers).

(b) The purpose of the security requirement is to ensure the licensee's financial responsibility. See section 2208(c)(1)(i) of the act.

(c) The amount and the form of the security, if not mutually agreed upon by the NGDC and the licensee, shall be based on the criteria established in this section. The criteria shall be applied in a nondiscriminatory manner. The Commission will periodically review the established criteria upon petition by any party. **THE NGDC SHALL INCLUDE THE RULES, FORMULAS AND STANDARDS IT USES TO CALCULATE AND ADJUST SECURITY AMOUNTS IN A TARIFF.**

(1) The amount of the security should be reasonably related to the financial exposure imposed on the NGDC or supplier of last resort resulting from the default or bankruptcy of the licensee. ~~At a minimum,~~ 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 AND THE AMOUNT PAYABLE BY THE LICENSEE'S RETAIL GAS CUSTOMERS during one billing cycle.

(i) The amount of security established under this paragraph may be modified based on one or more of the following:

(A) The licensee's past operating history ON THE NGDC'S SYSTEM AND ON OTHER NGDC SYSTEMS, including the length of time that the licensee operated on the ~~NGDC's~~ NGDC system, the number of customers served and past supply reliability problems.

(B) The licensee's credit reports.

(C) The number and class of customers being served.

(D) Information that materially affects a licensee's creditworthiness AS SET FORTH IN § 62.111(C)(II)(A)-(E).

(E) The licensee's demonstrated capability to provide the volume of natural gas necessary for its customers' needs.

(ii) The amount of the security may be adjusted AS CIRCUMSTANCES WARRANT, ~~but not more often than every 6 months.~~ The adjustments [shall] must be reasonable and based on one or more of the following criteria:

(A) Significant changes A CHANGE [Changes] in a licensee's recent operating history on the ~~NGDC's~~ NGDC system OR ON OTHER NGDC SYSTEMS that have HAS materially affected NGDC system operation or reliability. A CHANGE THAT

COULD MATERIALLY AFFECT NGDC SYSTEM OPERATION OR RELIABILITY MAY OCCUR WHEN A SUPPLIER FAILS TO DELIVER NATURAL GAS SUPPLY SUFFICIENT TO MEET ITS CUSTOMERS' NEEDS, OR FAILS TO COMPLY WITH NGDC OPERATIONAL FLOW ORDERS AS DEFINED AT 52 PA. CODE § 69.11 (RELATING TO DEFINITIONS).

(B) A change [Changes] in a licensee's credit reports that materially affects a licensee's creditworthiness. A LICENSEE'S CREDITWORTHINESS COULD BE MATERIALLY AFFECTED WHEN TWO OF THE FOLLOWING CREDIT RATING COMPANIES CHANGE THE LICENSEE'S CREDIT RATING:

- (I) DUN & BRADSTREET.
- (II) STANDARD & POORS RATING SERVICES INC.
- (III) TRANSUNION LLC.
- (IV) EQUIFAX INC.
- (V) EXPERIAN INFORMATION SOLUTIONS, INC.

(C) A significant change [Changes] in the number of customers SERVED, IN THE VOLUME OF GAS DELIVERED, OR IN THE UNIT PRICE OF NATURAL GAS or a change in the class of customers being served by the licensee. A CHANGE OVER A CONSECUTIVE 30 DAY PERIOD An increase of 25% in the number of customers SERVED, IN THE VOLUME OF GAS DELIVERED OR IN THE AVERAGE UNIT PRICE OF NATURAL GAS would represent a significant change that would justify an NGDC directing that additional security be provided.

(D) A change [Changes] in OPERATIONAL OR FINANCIAL circumstances that materially affects [affect] a licensee's creditworthiness. A LICENSEE'S CREDITWORTHINESS COULD BE MATERIALLY AFFECTED WHEN TWO OF THE FOLLOWING INVESTMENT RATING COMPANIES CHANGE THE LICENSEE'S RATING OF ITS ISSUED SECURITIES FROM AN INVESTMENT

GRADE OR GOOD RATING TO A SPECULATIVE OR MODERATE CREDIT RISK RATING, AND VICE VERSA:

- (I) STANDARD AND POOR'S RATING SERVICES, INC.
- (II) MOODY'S INVESTMENT SERVICE, INC.
- (III) FITCH, INC.
- (IV) A. M. BEST COMPANY, INC.
- (V) DBRS, INC.

(E) A change in the [The] licensee's demonstrated capability to provide the volume of natural gas necessary for its customers' needs that materially affects NGDC system operation or reliability. A CHANGE THAT COULD MATERIALLY AFFECT NGDC SYSTEM OPERATION OR RELIABILITY MAY OCCUR WHEN A SUPPLIER FAILS TO DELIVER NATURAL GAS SUPPLY SUFFICIENT TO MEET ITS CUSTOMERS' NEEDS ON FIVE SEPARATE OCCASIONS WITHIN A 30 DAY PERIOD, OR FAILS TO COMPLY WITH NGDC OPERATIONAL FLOW ORDERS AS DEFINED AT 52 PA. CODE § 69.11(RELATING TO DEFINITIONS).

(2) The following legal and financial instruments and property shall be acceptable as security:

- (i) Bond.
- (ii) Irrevocable letter of credit.
- (iii) Corporate, parental or other third-party guaranty.
- (iv) Escrow account.

(v) Accounts receivable pledged OR ASSIGNED TO A ~~to the~~ NGDC ~~or sold by a~~ LICENSEE ~~supplier~~ participating in a THE NGDC'S NGDC purchase of receivables program that HAS BEEN APPROVED BY THE COMMISSION AS BEING is consistent with Commission orders, guidelines and regulations governing such programs.

(vi) Calls on capacity, NETTING NGDC GAS SUPPLY PURCHASES FROM THE NGS AGAINST NGS SECURITY REQUIREMENTS, or other operational offsets as may be mutually agreed upon by the NGDC and the NGS.

(VII) CASH.

(3) In addition to the requirements in this section, small suppliers with annual operating revenues of less than \$1 million may utilize real or personal property AS SECURITY with the following supporting documentation ~~acceptable as security~~:

(i) A verified statement from the licensee that it has clear title to the property and that the property has not been pledged as collateral, or otherwise encumbered in regard to any other legal or financial transaction.

(ii) A current appraisal report of the market value of the property.

(4) When practicable, the NGDC shall use applicable North American Energy Standards Board forms or language for financial and legal instruments that are used as security.

(5) The NGDC shall file an annual report with the Secretary no later than April 30 of each year. The report must contain the following information for the prior calendar year:

(i) The criteria that is being used to establish the amount of security that AN APPLICANT ~~a supplier~~ must provide TO THE NGDC IN ORDER to be granted a license BY THE COMMISSION.

(ii) The criteria that is being used to determine the amount of security that a ~~supplier~~ LICENSEE must provide to ENSURE ITS FINANCIAL RESPONSIBILITY IN ORDER TO maintain a license.

(iii) The criteria that is being used to determine that a change in the amount of security is needed for the ~~supplier~~ LICENSEE to maintain a license.

(iv) The number of ~~times~~ INSTANCES in the last ~~quarter~~ YEAR that the NGDC determined that a change in the ~~level~~ AMOUNT of security was needed for a ~~supplier~~ LICENSEE to maintain its license. FOR EACH INSTANCE, THE FOLLOWING INFORMATION SHALL BE REPORTED:

- (A) THE NAME OF THE LICENSEE INVOLVED.
- (B) THE DATE OF THE NGDC'S DETERMINATION.
- (C) THE REASON FOR THE DETERMINATION.
- (D) THE LICENSEE'S RESPONSE TO THE NGDC DETERMINATION.

(v) The types of legal INSTRUMENTS, ~~and financial instruments and property, real and personal,~~ that the NGDC accepted as security for licensing purposes. FOR EACH SECURITY TYPE REPORTED, THE FOLLOWING INFORMATION SHALL BE REPORTED:

- (A) THE NAME OF THE APPLICANT OR LICENSEE INVOLVED.
- (B) THE NAME AND ADDRESS OF THE BANK, COMPANY OR OTHER ENTITY THAT IS ACTING AS THE SURETY OR GUARANTOR.
- (C) THE AMOUNT OF SECURITY.
- (D) THE DATE THAT THE SECURITY WAS POSTED.

(6) WHEN A NGDC DETERMINES THAT AN ADJUSTMENT IN THE AMOUNT OR TYPE OF SECURITY THAT A LICENSEE MUST PROVIDE TO MAINTAIN ITS LICENSE IS WARRANTED, THE NGDC SHALL PROVIDE NOTICE OF ITS DETERMINATION TO THE LICENSEE IN WRITING. THE NGDC'S DETERMINATION SHALL BE BASED ON THE CRITERIA LISTED IN § 62.111(C)(1)(2)(3). THE LICENSEE SHALL COMPLY WITH THE NGDC'S DETERMINATION NO LATER THAN 5 BUSINESS DAYS AFTER THE DATE THAT THE LICENSEE WAS SERVED WITH NOTICE OF THE NGDC'S DETERMINATION. WHEN THE LICENSEE DISAGREES WITH THE NGDC'S DETERMINATION, THE LICENSEE MAY FILE A DISPUTE WITH THE NGDC PURSUANT TO § 62.111(C)(8).

(7) A LICENSEE MAY REQUEST THAT THE NGDC ADJUST THE AMOUNT OR TYPE OF SECURITY THE LICENSEE MUST PROVIDE TO MAINTAIN ITS LICENSE. THE LICENSEE SHALL PROVIDE ITS REQUEST IN WRITING TO THE NGDC. THE REQUEST SHALL BE BASED ON CRITERIA LISTED IN SECTION 62.111(C)(1)(2)(3). THE NGDC SHALL MAKE ITS DETERMINATION ON THE REQUEST AND SHALL PROVIDE A WRITTEN RESPONSE TO THE LICENSEE WITHIN 5 BUSINESS DAYS AFTER THE DATE THAT THE REQUEST WAS MADE. WHEN THE NGDC AGREES TO THE REQUESTED ADJUSTMENT IN SECURITY, THE LICENSEE SHALL POST THE SECURITY WITHIN 5 BUSINESS DAYS AFTER THE DATE THAT THE LICENSEE WAS SERVED WITH NOTICE OF THE NGDC'S DETERMINATION. WHEN THE LICENSEE DISAGREES WITH THE NGDC'S DETERMINATION, THE LICENSEE MAY FILE A DISPUTE WITH THE NGDC PURSUANT TO § 62.111(C)(8).

(8) When there is a dispute relating to the form or amount of security, the NGS APPLICANT OR LICENSEE SHALL NOTIFY THE NGDC OF THE DISPUTE AND

ATTEMPT TO RESOLVE THE DISPUTE. IF A RESOLUTION IS NOT REACHED WITHIN 30 DAYS AFTER THE DATE THAT THE NGDC IS NOTIFIED OF THE DISPUTE, THE APPLICANT OR THE LICENSEE may:

(i) Submit the dispute to the Secretary for assignment to the appropriate bureau, OFFICE, OR OTHER DESIGNATED UNIT for informal mediation and resolution. A PARTY DISSATISFIED WITH THE STAFF DETERMINATION MAY FILE A PETITION FOR APPEAL FROM A DECISION MADE BY THE BUREAU PURSUANT TO 52 PA. CODE § 5.44 (RELATING TO PETITIONS FOR APPEAL FROM STAFF) OR MAY FILE A FORMAL COMPLAINT WITH THE COMMISSION PURSUANT TO 52 PA. CODE §§ 5.21-5.22 (RELATING TO FORMAL COMPLAINTS GENERALLY AND CONTENT OF FORMAL COMPLAINT).

(ii) File a formal complaint with the Commission and request alternative dispute resolution by the Office of Administrative Law Judge.

(iii) File a formal complaint with the Commission and proceed with the litigation of the complaint.

(iv) File a petition with the Commission and request review of the criteria used by the NGDC.

(9) WHEN A LICENSEE SUBMITS A DISPUTE OR FILES A FORMAL COMPLAINT RELATING TO AN ADJUSTMENT IN SECURITY BY A NGDC, THE FOLLOWING OBLIGATIONS SHALL APPLY:

(I) THE LICENSEE SHALL PROVIDE TO THE NGDC THE ADJUSTED SECURITY AMOUNT AS DIRECTED BY THE NGDC. THE LICENSEE SHALL

MAINTAIN THE ADJUSTED AMOUNT OF SECURITY UNTIL THE DISPUTE OR COMPLAINT IS RESOLVED OR UNTIL DIRECTED OTHERWISE BY THE COMMISSION.

(II) THE LICENSEE SHALL CONTINUE TO OPERATE ON THE NGDC SYSTEM IN ACCORDANCE WITH SYSTEM OPERATION AND BUSINESS RULES AND PRACTICES UNTIL THE DISPUTE OR COMPLAINT IS RESOLVED OR UNTIL DIRECTED OTHERWISE BY THE COMMISSION.

(III) THE LICENSEE SHALL CAUSE TO BE DELIVERED TO THE NGDC SYSTEM NATURAL GAS SUPPLY IN THE VOLUME NECESSARY TO FULFILL ITS CUSTOMERS REQUIREMENTS AND SHALL PROVIDE CUSTOMER SUPPORT SERVICES UNTIL THE DISPUTE OR COMPLAINT IS RESOLVED OR UNTIL DIRECTED OTHERWISE BY THE COMMISSION.

(IV) THE NGDC SHALL PERMIT THE LICENSEE TO CONTINUE TO OPERATE ON THE NGDC SYSTEM UNTIL THE DISPUTE OR COMPLAINT IS RESOLVED OR UNTIL DIRECTED OTHERWISE BY THE COMMISSION.

(d) The licensee shall submit to the Commission documentation demonstrating that it has complied with the bonding or security requirement. One copy of each bond, letter of credit, or other financial or legal instrument or document evidencing an agreement between the licensee and the NGDC shall be submitted to the Commission.

(e) Licensee liability for violations of 66 Pa.C.S. (relating to the Public Utility Code) and Commission orders and regulations is not limited by these security requirements.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

**Licensing Requirements for Natural Gas
Suppliers; SEARCH Final Order and
Action Plan: Natural Gas Supplier
Issues**

**Public Meeting – June 16, 2010
2069115-LAW
Docket Nos. L-2008-2069115
I-00040103F0002**

STATEMENT OF VICE CHAIRMAN TYRONE J. CHRISTY

Before the Commission for consideration is the Final Rulemaking Order in the above captioned matter, recommending approval of revisions to the Commission's security requirements for licensing of natural gas suppliers (NGSs) at 52 Pa. Code §§ 62.101-62-114. This rulemaking resulted from our September 11, 2008 Final Order and Action Plan regarding the Commission's *Investigation into the Natural Gas Supply Market: Report on Stakeholder's Working Group (SEARCH Order)*, Docket No. I-00040103F0002. In the SEARCH Order, the Commission determined that one way to increase effective competition in the retail natural gas market was to revise the NGS licensing regulations in regard to the level of security needed and the forms of security that could be used to satisfy the statutory security requirement for licensing. Seven parties filed comments in response to the proposed rulemaking order: the Energy Association of Pennsylvania (EAPA); Philadelphia Gas Works (PGW); National Fuel Gas Distribution Company (NFG); Equitable Gas Company (Equitable); PECO Energy (PECO); the NGS Parties and the Retail Energy Supply Association (RESA).

I am concerned about one aspect of the proposed revisions to our licensing requirements, that being the inclusion of accounts receivable pledged or assigned to a natural gas distribution company (NGDC) by a supplier participating in a NGDC purchase of receivables (POR) program as an acceptable form of security. It is important to note that financial security requirements for NGSs are necessitated by Section 2207(k) of the Public Utility Code, 66 Pa.C.S. § 2207(k), which requires a NGDC, acting as supplier-of-last-resort, to charge customers returning from a defaulting NGS the rates the NGS would have charged the customer for the remainder of the billing cycle. The statute provides, "Any difference between the cost incurred by the supplier of last resort and the amount payable by the retail gas customer shall be recovered from the natural gas supplier or from the bond or other security provided by the natural gas supplier..." The purpose of the bond or other security is to ensure the financial responsibility of the NGS.

The addition of accounts receivable as a form of security has created significant concerns from several of the parties submitting comments to this rulemaking proceeding. The EAPA states that participation in a NGDC POR program by a NGS may reduce the financial risk or exposure created by the default or bankruptcy of a NGS and may impact the amount of security necessary, but participation in the program cannot in itself be the security. NFG states that the notion that an entity could use something it has sold or pledged as security is fundamentally

flawed. NFG avers that the receivables may reduce the financial exposure imposed by a NGS on a NGDC, but the impact will not be a security instrument. PGW states that receiving a pledge of accounts receivable is not as simple as receiving a bond, a letter of credit or being the beneficiary of money deposited into escrow. PGW avers that it is simply not possible for a supplier to provide a security interest in accounts receivable that it does not own. Equitable and PECO have submitted similar concerns on this issue and state that receivables do not adequately mitigate risk for NGDCs and should not be eligible for use as security.

I must respectfully dissent, partially, from the majority's decision today on this one aspect of the proposed rulemaking as I agree with the aforementioned comments that receivables pledged or assigned to a NGDC by a NGS participating in the NGDC's POR program should not be included as an acceptable security instrument or property. While I agree that the amount of receivables under a POR program may reduce the financial exposure by a NGS on a NGDC, that reduced financial exposure should be considered in the context of the overall NGDC formula for security. This formula would consider, among many details, the current level of customers, the volume of natural gas delivered and the average price of natural gas. As a result, I would have preferred that the proposed regulations rely upon adjustments to the level of security by the aforementioned issue and excluded the use of POR program receivables as a form of NGS security.

6-16-10

DATE

Tyrone J. Christy

TYRONE J. CRISTY, VICE CHAIRMAN

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EXECUTIVE SUMMARY

L-2008-2069115/57-266

Licensing Requirements for Natural Gas Suppliers;
SEARCH Final Order and Action Plan: Natural Gas Supplier Issues
52 Pa. Code Section 62.111

In its October 2005 *Report to the General Assembly*, the Public Utility Commission (PUC) found that there was not effective competition in Pennsylvania's retail natural gas market. The finding was based in part on the low number of natural gas suppliers (NGSs) participating in the market. Docket No. I-00040103. The amount of financial security required for NGS licensing was identified as a possible barrier to market entry and participation.

Based on the PUC's finding, stakeholders met to discuss ways to increase effective competition. The Staff's Report on the SEARCH collaborative suggested the use of reasonable criteria for adjusting the security amount required for NGS licensing and the use of NGS accounts receivable in natural gas distribution company (NGDC) Purchase of Receivables (POR) Programs as an acceptable type of security. On September 11, 2008, the PUC adopted these suggestions in its *Final Search Order and Action Plan*, Docket No. I-00040103F0002. On December 8, 2008, the PUC issued a proposed rulemaking order revising PUC NGS licensing regulations. The order was published at 39 Pa. B. 1657. A 60-day comment period was established. Seven parties and IRRC filed comments. The PUC issued its final rulemaking order on June 16, 2010.

This final rulemaking revises Section 62.111: (1) to permit the use of NGS accounts receivable in a PUC-approved POR program to satisfy part, or all of a NGS's security requirement; and (2) to list possible triggering events for adjusting the security amount and reasonable criteria for the adjustment of the security amount. This section also includes an annual reporting requirement for NGDCs on the adjustment of security amounts, and a list of PUC procedures, formal and informal, that a NGS may use to resolve a dispute over security with a NGDC. The PUC believes that the final regulation better balances a NGS's ability to provide adequate security to maintain its license with a NGDC's actual risk of financial loss in the event of supplier default.

The PUC contact persons are Patricia Krise Burket, 717-787-3463 (legal), and Annunciata Marino, 717 772-2152 (technical).



PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH OF PENNSYLVANIA
HARRISBURG, PENNSYLVANIA

JAMES H. CAWLEY
CHAIRMAN

September 28, 2010

The Honorable Arthur Coccodrilli
Chairman
Independent Regulatory Review Commission
14th Floor, Harristown II
333 Market Street
Harrisburg, PA 17101

Re: L-2008-2069115/57-266
Final Rulemaking
Licensing Requirements for Natural
Gas Suppliers
52 Pa. Code, Chapter 62

Dear Chairman Coccodrilli:

Enclosed please find one (1) copy of the regulatory documents concerning the above-captioned rulemaking. Under Section 745.5(a) of the Regulatory Review Act, the Act of June 30, 1989 (P.L. 73, No. 19) (71 P.S. §§745.1-745.15) the Public Utility Commission, on March 19, 2009, submitted a copy of the Notice of Proposed Rulemaking to the Senate Consumer Protection and Professional Licensure Committee, the House Committee on Consumer Affairs and the Independent Regulatory Review Commission (IRRC). This notice was published at 39 *Pa.B.* 1657 on April 4, 2009. The Commission also provided the Committees and IRRC with copies of all comments received in compliance with Section 745.5(b.1).

In preparing this final form rulemaking, the Commission has considered all comments received from the Committees, IRRRC and the public.

Very truly yours,

A handwritten signature in black ink that reads "James H. Cawley". The signature is written in a cursive style with a large, prominent initial "J".

James H. Cawley
Chairman

Enclosures

cc: The Honorable Robert M. Tomlinson
The Honorable Lisa Boscola
The Honorable Robert Godshall
The Honorable Joseph Preston, Jr.
Legislative Affairs Director Perry
Chief Counsel Pankiw
Assistant Counsel Burket
Ms. Marino
Regulatory Coordinator DeIBiondo
Judy Bailets, Governor's Policy Office

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT
THE REGULATORY REVIEW ACT

ID Number: L-2008-2069115/57-266

Subject: Licensing Requirements for Natural Gas Suppliers

Pennsylvania Public Utility Commission

TYPE OF REGULATION

- Proposed Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted.
- Final Regulation
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor

FILING OF REPORT

<u>Date</u>	<u>Signature</u>	<u>Designation</u>
9/28/10	Wendy Shearer	HOUSE COMMITTEE (Preston) Consumer Affairs
9/28/10	Mary Walmer	SENATE COMMITTEE (Tomlinson) Consumer Protection and Professional Licensure
9/28/10	K Cooper	Independent Regulatory Review Commission Attorney General
		Legislative Reference Bureau

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