

Regulatory Analysis Form

(Completed by Promulgating Agency)



IRRC

Independent Regulatory Review Commission

SECTION I: PROFILE

(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, 717-783-3458, 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). The proposed revisions will better balance the ability of a NGS to provide adequate security to maintain its licensed status 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; and (3) the development of reasonable criteria for NGDCs to use in adjusting the level of security that a NGS must have to maintain its license.

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

Not applicable.

- 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 regulations in regard to the adjustment of the amount of security, and acceptance of approved types of security such as NGS accounts receivable as part of a PUC-approved POR program.

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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 courts in *UGI Utilities, Inc. – Gas Division v. Pa. PUC*, 878 A. 2d 186 (Pa. Cmwlth. Ct. 2005) (the PUC 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 an NGS; criteria is for a “reasonably related” financial security requirement, not the worst case scenario as determined by the NGDC, which was 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 proposed 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 various ways to increase effective competition. The Staff’s Report on SEARCH posited that the use of reasonable criteria for adjusting the amount of security 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. This proposed rulemaking implements this solution.

NGSs will benefit directly from this proposed 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 proposed revision to existing regulations.

(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 proposed revision to the NGS licensing regulation. The purpose of the revision is to revise the regulations to require that adjustments to security amounts be reasonable and to permit other types of security, such as the purchase by the NGDCs of NGS accounts receivables in a PUC-approved purchase of receivables program, to be an acceptable form of security that may be used to satisfy requirements to obtain or retain a NGS license.

(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 this proposed revision to the regulations relating to the amount of and type of security required for a NGS to be licensed or maintain a license. There are currently 85 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 is being revised to lower the cost of security needed for licensing by requiring that adjustments to the level of security be reasonable, and be adjusted only when necessary to cover the risk to the NGDC of supplier default. No specific estimate of savings can be developed as the savings to each NGS will vary.

As to costs, the NGDC has been administering 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 financial security requirements will be incremental/minimal 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 will 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 reviewing security information for licensing NGSs 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 the proposed revision is 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, thereby increasing effective competition in the market. The costs to the NGDCs will be minimal as they are already incurring costs for the administration of 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 proposed revisions 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. The PUC held 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. A change in the licensing security requirement was identified as a means to increase the number of suppliers in the retail market. The revisions proposed offer the 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 the 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 behind the revision of the security requirement for NGS licensing is 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 for business development and expansion with other states.

(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 proposed revisions made to Section 22.111.

(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 is already administering financial security requirements for NGS licensing operating on its system. The PUC does not anticipate that legal, accounting or consulting, bookkeeping or other ministerial procedures already in place will be significantly affected by the proposed revisions to Section 62.111.

(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 proposed revisions were designed to meet the identified needs of natural gas suppliers in regard to the security requirement to obtain and maintain a NGS license. The regulation states that the security level needed for licensing must be reasonable. The proposed revisions extend this reasonableness standard to adjustment of security levels, and require that adjustment in the amount not be more often than every six months. The revision also revises the list of acceptable types of security 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.

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU

(Pursuant to Commonwealth Documents Law)

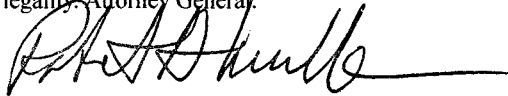
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BY _____
(DEPUTY ATTORNEY GENERAL)

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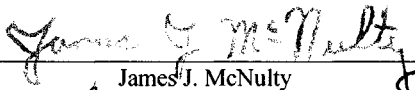
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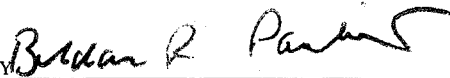
DOCUMENT/FISCAL NOTE NO. L-2008-2069115/57-266

DATE OF ADOPTION December 4, 2008

BY 
James J. McNulty

TITLE Secy
(SECRETARY)

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

BY 

Bohdan R. Pankiw
Chief Counsel

12-4-08

DATE OF APPROVAL

Check if applicable
Copy not approved. Objections attached

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

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

The Pennsylvania Public Utility Commission on December 4, 2008, adopted a proposed 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.

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* on its investigation into competition in Pennsylvania's retail natural gas market, the Public Utility Commission (PUC) found that there was not effective competition in the natural gas retail market 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 that a NGS needed to provide for licensing was identified as a possible barrier to market entry and participation. *See* 66 Pa.C.S. § 2208(c)(1)(i).

Based on the PUC's finding, a collaborative of stakeholders (SEARCH) was convened to discuss ways to increase effective competition. The Staff's Report on SEARCH suggested the use of reasonable criteria for adjusting the amount of security required for licensing and the use as security of NGS accounts receivable in Purchase of Receivables Programs (POR) as two ways to increase the number of suppliers participating in the retail market. The PUC adopted this suggestion in its *Final Search Order and Action Plan*, order entered September 11, 2008 at Docket No. I-00040103F0002 and directed that the PUC's regulations at 52 Pa. Code § 62.111 (relating bonds and other security) be revised accordingly.

This proposed rulemaking revises Section 62.111 to include: (1) the use of NGS accounts receivables in a PUC-approved POR program to satisfy part of, or the total security requirement; (2) the adoption of standard language for financial instruments used for security; and (3) the development of reasonable criteria for a natural gas distribution company (NGDC) to use in adjusting the level of security that a NGS must provide to maintain its license. The proposed revisions will 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.

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

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

Public Meeting held December 4, 2008

Commissioners Present:

James H. Cawley, Chairman
Tyrone J. Christy, Vice Chairman, Concurring in result only
Robert F. Powelson
Kim Pizzingrilli, Statement attached
Wayne E. Gardner

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

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

PROPOSED RULEMAKING ORDER

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 (*SEARCH Order*), Docket No. I-00040103F0002 (*SEARCH Order*), the Commission determined that one way to increase effective competition in the retail natural gas market was to revise the natural gas supplier licensing regulations² 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. Accordingly, this proposed rulemaking order sets forth revisions to the Commission's natural gas supplier 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.

² Natural gas supplier licensing regulations may be found at 52 Pa. Code §§62.101-62.114.

DISCUSSION

Section 2208(c)(1)(i) of the Public Utility Code establishes the security requirements for the issuance and maintenance of a natural gas supplier (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. The bonding amount must be based on criteria that were approved by the Commission in each natural gas distribution company's restructuring filing. 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. 52 Pa. Code § 62.111. This section reads as follows:

§ 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.

(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.

(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, including the length of time that the licensee operated on the NGDC's 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.

(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, but not more often than every 6 months. The adjustments shall be reasonable and based on one or more of the following criteria:

(A) Changes in a licensee's recent operating history on the NGDC's system.

(B) Changes in a licensee's credit reports.

(C) Changes in the number or class of customers being served by the licensee.

(D) Changes in circumstances that materially affect a licensee's creditworthiness.

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

(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.

(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 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.

(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.

In the *SEARCH Order*, the Commission identified NGDC security requirements as one barrier to supplier participation in the retail market³. 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

³ This subject is fully discussed in the *SEARCH Report* in Section I (Creditworthiness/Security) at pp. 18-21.

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. Ct. 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.

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 is in the public interest to initiate a rulemaking to address security requirements related to NGS licensing. *SEARCH Order*, p. 25. The task involves the revision of the NGS licensing regulations at Section 62.111 (relating to bonds or other security), and other related regulations in regard to the required level of security and the acceptable forms of security permitted to satisfy the statutory security requirement for licensing at 66 Pa.C.S. § 2208(c)(i) (relating to requirements for natural gas suppliers; financial fitness). The goal is to update the Commission's existing regulations regarding security requirements 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 receivables 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.

With this order, we initiate this proposed rulemaking. The following revisions are proposed to be made to the NGS licensing regulations at Section 62.111 (relating to bonds or other security).

Subsection 62.111(c)(1)(ii)

This subsection 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 have revised the criteria to make them more stringent. This means that only significant changes in the NGS's operation that would materially affect the NGDC system operation or reliability or that would materially affect the NGS's creditworthiness can trigger a review and adjustment.

Subsection 62.111(c)(2)

This subsection lists the legal and financial instruments that shall be acceptable for security. We have 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.

Subsection 62.111(c)(4)

This subsection is a new subsection and states that when practicable, the NGDC shall use applicable North American Energy Standards Board forms or language for financial and legal instruments.

Subsection 62.111(c)(5)

This subsection is a new subsection that 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.

Subsection 62.111(c)(6)

Subsection 62.111(c)(6) is a new subsection that 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 Office of Competitive Market Oversight⁴ will act as the mediator between the NGS and the NGDC.

CONCLUSION

The goal of this proposed rulemaking is to revise the security requirements for NGS licensing, lower barriers to market entry and to increase supplier participation. This is the first step of the *SEARCH Order's* Action Plan to increase effective competition in Pennsylvania's retail natural gas market.

The Commission seeks comments on the proposed revisions to our licensing regulations. Parties submitting comments are requested to provide supporting justification for requested revisions, and to propose regulatory language for incorporation into the final-form regulations.

Accordingly, pursuant to sections 501, 504 and 2203(12) and 2208 of the Public Utility Code, 66 Pa.C.S. § 501, 504, 2203(12) 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

⁴ In the 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 is to be created by January 5, 2009. The working name for the unit, Office of Competitive Market Oversight, is subject to change.

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 are proposing to amend our regulations as set forth in Annex A, attached hereto;

THEREFORE,

IT IS ORDERED:

1. That a rulemaking docket shall be opened to amend the regulations relating to bonds and other security at 52 Pa. Code § 62.111 and other related regulations as set forth in Annex A.
2. That the Secretary shall submit this Order and Annex A to the Office of Attorney General for review as to form and legality and to the Governor's Budget Office for review of fiscal impact.
3. That the Secretary shall submit this Order and Annex A for review and comments to the Independent Regulatory Review Commission and the Legislative Standing Committees.
4. That the Secretary shall certify this Order and Annex A and deposit them with the Legislative Reference Bureau to be published in the *Pennsylvania Bulletin*.
5. That an original and 15 copies of written comments referencing the docket number of the proposed regulations be submitted within 60 days of publication in the *Pennsylvania Bulletin* to the Pennsylvania Public Utility Commission, Attn.: Secretary, P.O. Box 3265, Harrisburg, PA 17105-3265. To facilitate posting, all filed comments

shall be forwarded via electronic mail to Patricia Krise Burket at pburket@state.ps.us, Annunciata Marino at annmarino@state.pa.us, and Cyndi Page at cypage@state.pa.us

6. That a copy of this Order and Annex A shall be served on all jurisdictional natural gas distribution companies, all licensed natural gas suppliers, the Office of Consumer Advocate, the Office of Small Business Advocate and all other parties that filed comments at the Docket number I-00040103.

7. That the contact persons for this Proposed Rulemaking are Patricia Krise Burket, Law Bureau, 717-787-3463 (legal) and Annunciata Marino, 717-772-2151 (technical).

BY THE COMMISSION

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: December 4, 2008

ORDER ENTERED: December 8, 2008

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.

(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.

(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, including the length of time that the licensee operated on the NGDC's 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.

(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, but not more often than every 6 months. The adjustments shall be reasonable and based on one or more of the following criteria:

(A) Significant changes [Changes] in a licensee's recent operating history on the NGDC's system that have materially affected NGDC system operation or reliability.

(B) A change [Changes] in a licensee's credit reports that materially affects a licensee's creditworthiness.

(C) A significant change [Changes] in the number of customers or a change in the class of customers being served by the licensee. An increase of 25% in the number of customers would represent a significant change that would justify an NGDC directing that additional security be provided.

(D) A change [Changes] in circumstances that materially affects [affect] a licensee's creditworthiness.

(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.

(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 to the NGDC or sold by a supplier participating in a NGDC purchase of receivables program that is consistent with Commission orders, guidelines and regulations governing such programs.

(vi) Calls on capacity or other operational offsets as may be mutually agreed upon by the NGDC and the NGS.

(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 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 shall contain the following information for the prior calendar year:

(i) The criteria that is being used to establish the amount of security that a supplier must provide to be granted a license.

(ii) The criteria that is being used to determine the amount of security that a supplier must provide 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 to maintain a license.

(iv) 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.

(v) The types of legal and financial instruments and property, real and personal, that the NGDC accepted as security for licensing purposes.

(6) When there is a dispute relating to the form or amount of security, the NGS may:

(i) Submit the dispute to the Secretary for assignment to the appropriate bureau for informal mediation and resolution.

(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.

(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
COMMONWEALTH OF PENNSYLVANIA
HARRISBURG, PENNSYLVANIA

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INDEPENDENT REGULATORY
REVIEW COMMISSION

THE CHAIRMAN

March 19, 2009

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
Proposed Rulemaking
Licensing Requirements for Natural
Gas Suppliers
52 Pa. Code, Chapter 62

Dear Chairman Coccodrilli:

Enclosed please find one (1) copy of the proposed rulemaking and the Regulatory Analysis Form prepared in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." Pursuant to Section 5(a) of the Regulatory Review Act of June 30, 1989 (P.L. 73, No. 19) (71 P.S. §§745.1-745.15) the Commission is submitting today a copy of the proposed rulemaking and Regulatory Analysis Form to the Chairman of the House Committee on Consumer Affairs and to the Chairman of the Senate Committee on Consumer Protection and Professional Licensure.

The purpose of this rulemaking is to revise 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.

The proposal has been deposited for publication with the Legislative Reference Bureau.

Very truly yours,


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 DelBiondo
Judy Bailets, Governor's Policy Office

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT
TO 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

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REVIEW COMMISSION

FILING OF REPORT

Date

Signature

Designation

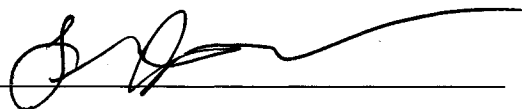
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HOUSE COMMITTEE (Preston)

Consumer Affairs

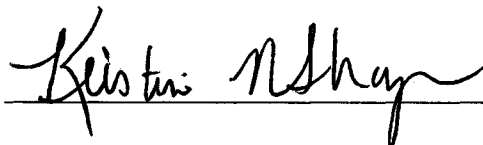
3/19/09



SENATE COMMITTEE (Tomlinson)

Consumer Protection and
Professional Licensure

3/19/09



Independent Regulatory
Review Commission

Attorney General

Legislative Reference
Bureau