

PROJECT NO. 35767

**PUC RULEMAKING RELATING § PUBLIC UTILITY COMMISSION
TO CERTIFICATION OF RETAIL § OF TEXAS
ELECTRIC PROVIDERS §**

**ORDER ADOPTING THE REPEAL OF §25.107 AND NEW §25.107
AS APPROVED AT THE APRIL 23, 2009 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts the repeal of §25.107, relating to Certification of Retail Electric Providers without changes, and adopts new §25.107, relating to Certification of Retail Electric Providers, with changes to the proposed text as published in the November 7, 2008 issue of the *Texas Register* (33 TexReg 9032). The new rule strengthens the certification requirements for retail electric providers (REPs) in order to better protect customers, transmission and distribution utilities (TDUs), and other REPs from the insolvency of REPs and other harmful conditions and activities of REPs. This rule is a competition rule subject to judicial review as specified in Public Utility Regulatory Act (PURA) §39.001(e). The rule is adopted under Project Number 35767.

A public hearing on the rule was held at commission offices on December 30, 2008. The commission received comments on the proposed rule from Alliance for Retail Markets (ARM); Bounce Energy, Inc. (Bounce); En-Touch Systems, Inc.(En-Touch); First Choice Power (First Choice); Integrys Energy Services, Constellation NewEnergy, Inc., and Direct Energy LP (Integrys, Constellation and Direct Energy); Joint TDUs; National Energy Marketers Association (NEM); NRG Texas, LLC (NRG); Office of Attorney General (OAG); Office of Public Counsel (OPC); REPower Energy (REPower); Shell Energy North America (Shell); Steering Committee of Cities served by Oncor (Cities); Tara Energy, Inc (Tara); Reliant Energy (Reliant); Texas

Industrial Energy Consumers (TIEC); Texas Ratepayers Organization to Save Energy and Texas Legal Services Center (Texas ROSE/TLSC); TXU Energy Retail Company, LLC (TXU); and Whaley Consulting on behalf of REPs for Competitive Markets (RCM).

Summary of Comments

Question 1: How can the commission protect customer deposits from a REP bankruptcy while still allowing the REP access to the deposits to cover nonpayment? Please provide specific language for a letter of credit, escrow agreement, or other instrument that would accomplish this purpose.

Cities stated that an irrevocable stand-by letter of credit (LC) and escrow agreement would provide for the refund of customer deposits as soon as possible after the REP experiences a triggering event such as bankruptcy, default on TDU obligations, refusal to return customer deposits when due, or an announcement that it will cease operations. Cities stated that the refund of customers' funds should be a higher priority than protecting the REP from customer non-payments. Cities stated that the collection of customer deposits is a privilege of REP certification and the occurrence of a triggering event would indicate that the REP is not in compliance with the rules and certification requirements. Cities stated that the triggering event could be made dependant on a commission order specifying the amount of customer deposits, which are unencumbered by unpaid bills. However, Cities noted that this approach could result in excessive delays in refunding deposits because of potential obstacles, such as the time required for commission Staff to review records and possible contested hearings. Cities stated

that a rapid refund of the defaulting REP's deposits is necessary to protect customers from the burden of duplicative deposits in the event that the REP ceases operations and the customer is dropped to a POLR with a corresponding new deposit requirement. Cities stated that if the commission believes it is necessary to provide some offset for unpaid bills, then 90% of the deposits should be returned, and 10% of the deposits should be held in reserve until the issue of uncollectible accounts has been resolved. Finally, Cities stated that the LC or escrow agreement could account for this type of provision, which would be based upon the commission finding that a triggering event had occurred. Cities did not provide any specific language for the development of a LC or escrow agreement but stated that the terms should be as specific as possible, with triggering events clearly defined in a manner that minimizes ambiguity or dispute.

TXU agreed, in part, with Cities that a trigger mechanism that helps establish the proper criteria to identify failing REPs is important relative to the bankruptcy parameters that allow the REP to return customer deposits prior to declaring bankruptcy. To the extent the commission relies on a LC, TXU supplied sample LC language.

TXU suggested a possible approach to protecting customer deposits from the bankruptcy estate is to seek a change to federal bankruptcy law to exclude customers' deposits. TXU stated that a resolution from the Texas Legislature asking the United States Congress to create such an exception would be appropriate.

ARM took no substantive position on the proposed standard language for use in a LC and recognized that TXU's sample LC may meet the necessary requirements for such a financial instrument.

Texas ROSE/TLSC and OPC agreed with the concept that customer deposits should be protected. Texas ROSE/TLSC stated that the deposit money and funds paid in advance for prepaid service should remain the property of the customer unless the deposit is used to pay off the final balance on the customer's account. The OAG supported this concept. Texas ROSE/TLSC agreed, in part, with Cities that customer funds should be held in an escrow account in the name of the REP, but did not comment on the LC. In addition, Texas ROSE/TLSC recommended that the accounts should be Federal Deposit Insurance Corporation (FDIC) insured accounts under the Transaction Account Guarantee Program (TAGP) with the pooled interest payments forwarded to the non-profit agencies that administer the REPs bill payment assistance program. Texas ROSE/TLSC stated that placing customer deposits in this type of account would provide the highest level of protection and would provide an additional social benefit at no cost to the REP or to the customer. Texas ROSE/TLSC suggested the program could be modeled after the Interest on Lawyers Trust Accounts program administered by the Texas Supreme Court. The OAG stated that the rule should clarify that customer deposits and advance payments remain the customers' property until the customer defaults on an obligation. The OAG recommended that this requirement would help exclude customer deposits and advance payments from a REP's bankruptcy estate. The OAG suggested that the commission review mechanisms used by other State agencies and, as a reference, cited Texas Tax Code §11.016. The OAG also cited Texas Finance Code §154.001 et seq., which requires

providers of pre-paid funeral services to deposit their customers funds in a separate trust fund. The OAG suggested the possibility of using a LC or a surety bond as a means of assuring customers' property is returned to customers.

Joint TDUs agreed with Texas ROSE/TLSC and, in part, with Cities that customer funds should be held in an escrow account, stating that this arrangement provides the most efficient way of ensuring that customer deposits are protected and are available to be refunded to customers in the event of a REP failure.

OPC, RCM and ARM did not have a suggestion as to a specific financial instrument that would protect the deposits. OPC stated that deposits are not to be considered the property of the REP and could not be accessed by the REP's creditors in the event of a bankruptcy. RCM stated that the primary goal for collecting deposits by the REP is to cover any unpaid balances on the customers' accounts, and urged the commission to institute protections that achieve the primary goal while imposing the least incremental cost and operational burden on REPs. RCM stated that to maintain a LC or an escrow account would result in additional cost to the REP, which may ultimately be borne by the customer, but did not state a preference for either proposal. RCM agreed that, even in bankruptcy, the deposits of customers who have paid their bills in full should be returned in a speedy manner, after determining account balances. RCM mentioned the problem REPs face when customers cease to pay upon hearing that their provider is having difficulties, leaving the REP to sort through unpaid obligations. ARM discussed Section 507 of the Bankruptcy Code and stated that REP assets become part of the property of the estate and are protected by the bankruptcy trustee for the benefit of creditors. ARM stated that the use of a

third party to administer a segregated fund of customer monies would not impact the REP's ownership of the asset. RCM stated that it would support a reasonable proposal to keep deposits separate while maintaining operational access to the funds.

Reliant and TXU agreed with the commission's proposal to provide a menu of options from which REPs may choose. Reliant stated their preference for the use of segregated cash accounts along with record-keeping that would allow the tracing of specific deposits to specific customers as outlined in §25.478(h) and §25.478(j), which specify requirements for refunding deposits and the conditions under which a REP can retain the deposit. Reliant stated that its approach would be the least-cost option that allowed for day-to-day deposits and reimbursements. Reliant stated that this option meets the bankruptcy case law standards for keeping deposits from becoming part of the bankruptcy estate. Reliant did not oppose escrow accounts, but noted that escrow accounts are cumbersome for management of customer deposits on a daily basis, involve a third party to whom the REP would have to apply for disbursements, add costs with no concomitant benefit, and provide no additional security. Reliant did not oppose the option of a LC, but stated that such an approach is more complex than a segregated cash account. Reliant mentioned several issues are associated with the use of a LC, and stated that the most important feature of a LC is the draw statement, which specifies the conditions that allow for the draw on the LC.

TEAM agreed with Reliant and supported its recommendation. TEAM stated that the financial mechanism should be designed in a manner that allows the REP to access the funds to cover non-payment, accommodates frequent transactions, does not add undue administrative costs, and protects customer deposits.

Shell agreed with ARM, RCM, and Reliant regarding the concept of segregated accounts and how these accounts could help protect customer deposits in a bankruptcy proceeding. Shell stated that a segregated account provides transparency as long as funds are not commingled with other funds. Shell stated that the rule should clearly spell out that these funds are third party funds and not the REP's property, and may be used by the REP only in the event that the customer has defaulted and the terms of service allow for the use of the deposit to satisfy unpaid bills.

Shell agreed with ARM that the segregated accounts should be administered by a third party but did not offer a recommendation as to a third party.

Shell disagreed with Cities regarding a LC or an escrow account. Shell stated that LCs are problematic alternatives and "absent external support, no financial institution will issue a LC unless it has possession of the issuer's funds or acceptable collateral in an equivalent amount," which means that under the rule every REP would need to maintain the funds in an escrow account. Shell mentioned three problems associated with escrow accounts: the tracking and the returning of each customer deposit if the REP defaults, the ability to terminate an escrow account and claim the funds before the REP defaults, and whether or not the funds in such an account would be returned to customers if the REP declared bankruptcy.

Cities expressed their skepticism of proposals that allow the use of restricted cash accounts, and disagreed with Reliant's proposal to extend the use of restricted cash accounts to all REPs.

Cities stated that a creditor foreclosing on a REP's collateral might sweep all bank accounts, regardless of the identification of the account as restricted.

TXU disagreed with Cities regarding LCs and escrow accounts. TXU stated that financially reliable REPs are required to pay additional costs of providing credit support such as a LC, restricted cash account, or escrow account. TXU stated that financially reliable REPs should be able to maintain adequate liquid capital to cover customer deposits.

Reliant disagreed with Texas ROSE/TLSC's recommendation that all REPs use an escrow account, and stated that for those REPs that have significant daily deposit activity, an escrow account is not administratively feasible and would become cumbersome and costly.

ARM and TXU disagreed with Texas ROSE/TLSC and opposed their proposal to keep customer deposits in one or more FDIC insured accounts protected under the TAGP. ARM stated that this methodology will preclude REPs from earning any interest on those segregated monies, despite the requirement in §25.478(f) requiring REPs to pay interest on customer deposits. ARM also stated that REPs should not be restricted from at least partially funding this interest payment obligation during their retention of those deposit monies.

Commission Response

The commission disagrees with TXU that financially strong REPs should be allowed to maintain adequate liquid capital to cover customer deposits. One of the challenges for the commission in adopting this rule is to balance the interest of particular customers in

adequate security for the amounts they deposit with a REP and the interest of all customers in a vibrant retail market. The problems that the market experienced in 2008, when several REPs failed, without returning all deposits and advance payments to customers, was one of the reasons that the commission reviewed the REP certification requirements, and the commission concludes that, in light of these circumstances, providing additional security for customers is appropriate. The commission finds that deposits and advance payments should be held in a segregated cash account or an escrow account, or secured by an irrevocable stand-by letter of credit, to increase the probability that the customer deposits and advance payments will be protected from the bankruptcy of the REP.

The commission disagrees with Cities and Texas ROSE/TLSC concerning the use of restricted (segregated) cash accounts. The commission finds that segregated cash accounts, coupled with the other financial strength or security requirements in the rule, will adequately protect customer deposits held by REPs. The rule will give REPs three options for managing customer deposits. A REP with a high level of financial strength, that is one that meet the requirements of subsection (f)(1)(A), may use a segregated cash account that meets the requirements of subsection (f)(2)(A), may use an escrow account, or may provide a LC to secure 100% of the customer deposits. REPs that meet the requirements of subsection (f)(1)(B) may use a segregated cash account that meets the financial requirements of subsection (f)(2)(B), may use an escrow account, or may provide a LC to secure 100% of the customer deposits. A segregated cash account under subsection (f)(2)(B) must be deposited with an FDIC insured institution and be subject to the control of a creditor of the REP. The third option relates to advance payments by a REP offering

prepaid service, and a REP that takes advantage of this option may use an escrow account or letter of credit. It is reasonable to conclude that deposits held in segregated cash accounts by REPs that meet the commission's standard for creditworthiness under subsection (f)(1)(A) are protected because the probability of default for these REPs is very low. It is also reasonable to conclude that deposits held in segregated cash accounts by REPs that meet the requirements of subsection (f)(2)(B) are protected because a segregated cash account under subsection (f)(2)(B) is subject to the control or management of a provider of credit to the REP. The commission provides the option to use a segregated cash account pursuant to subsection (f)(2)(B) for the specific purpose of accommodating lockbox arrangements with providers of wholesale power supply to the extent the accounts are controlled and managed by that provider.

The commission disagrees with Texas ROSE/TLSC that REPs should hold deposits in TAGP accounts. The commission agrees with ARM and TXU that such accounts are non-interest bearing accounts that would inhibit a REP's ability to pay interest on customer deposits as required by §25.478(f). The commission agrees with Texas ROSE/TLSC, in part, concerning the holding of deposits in FDIC insured accounts. The commission is applying this requirement to segregated cash accounts for REPs that do not meet the financial standards under subsection (f)(1)(A).

Question 2: How should such a program be administered? For example, should the REP use its bank to hold and disburse customer deposits or should some other third party be used?

Reliant and RCM did not support a third party administrator because it would be too cumbersome for day-to-day operations. Reliant stated their preference for the use of segregated cash accounts along with record-keeping that allows tracing of specific deposits to specific customers as outlined in §25.478(h) and §25.478(j), which specify requirements for refunding deposits and the conditions under which a REP can retain the deposit. RCM stated that a third party entity would be faced with developing both fee schedules and procedural guidelines to govern its operation, which would add costs to the REPs and consequently to the customers. RCM stated that if it is forced to choose between the two alternatives, RCM would opt for a standardized arrangement with a commercial bank acting as a custodian for all customer deposits in a manner that is similar to the LITE-UP administration.

OPC suggested that a third party administrator would be most effective for keeping the deposit money segregated from the REP's capital or operating funds. OPC mentioned ERCOT as one option for a third party administrator and stated that it is perfectly situated to assume the task of switching the deposit money from the old REP to the new REP when customers switch REPs. OPC stated that ERCOT could also handle the task of refunding money to the customer or to the prior REP if the customer left a balance due.

Cities stated that either approach would be acceptable as long as the third party is independent of the REP and has an acknowledged fiduciary responsibility to the beneficiaries of the LC or escrow agreement.

Texas ROSE/TLSC agreed with OPC that ERCOT should be used as a third party as this allows ease of transfer for security funds and billing credits from one REP to another during a mass transition or when a customer switches REPs.

Texas ROSE/TLSC also proposed a hybrid alternative that requires each REP to hold funds in an insured TAGP account. A designated ERCOT official (or the PUC's executive director) would be an account co-signer. The PUC would have a standard agreement with each REP that details the circumstances in which the co-signer would exercise the legal authority to transfer funds to the POLR or other acquiring REP. Texas ROSE/TLSC recommended assistance from the Office of Attorney General be sought in drafting the required legal instrument that would be uniform for all REPs.

Reliant opposed Texas ROSE/TLSC's proposal for a "co-signer" concept as inappropriately transferring access to funds rightfully held by the REP on behalf of its customers.

Commission Response

The commission disagrees with OPC and Texas ROSE/TLSC that a third party administrator would be the most effective method to segregate deposits from a REP's operating funds. The commission agrees with Reliant and RCM that the use of a third party administrator to manage customer deposits is too cumbersome for day-to-day operations and is not a cost-effective solution. The commission believes that such a system, whether it is administered by ERCOT or some other third party, would require substantial

development and would add substantial new costs to the market. In addition, the use of a third-party administrator would increase the cost without providing a net benefit.

Question 3: What mechanism would provide the most cost-effective means of protecting customer deposits in the event of a REP failure, including bankruptcy?

Cities provided the following three mechanisms that would provide the most cost-effective means of protecting customer deposits: a LC, requiring some form of insurance (*i.e.*, bond), or an escrow agreement. Cities stated that a LC is intended to provide protection to the beneficiary in the event of bankruptcy or insolvency. Cities also stated that the LC be structured so that it is not considered the property of the REP and any draw will not be impaired by bankruptcy of the REP. Cities stated that the requirement of some form of insurance could prove to be more cumbersome and expensive, and bonds may not be readily available to the REP at a reasonable cost. Finally, Cities stated that some REPs with lesser financial resources may have difficulty obtaining a LC on their terms. Cities concluded that discussion in the workshop for this project indicated that the escrow approach was viewed as the most cost effective mechanism for such REPs.

Texas ROSE/TLSC stated that until a rule is adopted that fully describes the requirements for protecting customer deposits, it is impossible to determine the most cost effective means of protecting the deposits. Texas ROSE/TLSC stated that the mechanism should be measured for its cost effectiveness to the customer and not the REP.

Joint TDUs stated that customer funds should be held in an escrow account, which provides the most efficient way of ensuring that customer deposits are protected and are available to be refunded to customers in the event of a REP failure.

Reliant stated that allowing a REP to maintain the funds in a separate account in its own bank would be the most cost-effective method.

TEAM and TXU recommended that the commission retain an expert to study the wide array of banking products that may be available such as escrow agreements, disbursement accounts, trust accounts, reserve bank accounts, or other cash accounts to determine whether one or more meets the commission's goals.

Commission Response

The commission finds that providing REPs with the option of using segregated cash accounts, escrow accounts, and irrevocable stand-by letters of credit is the most cost-effective way to secure customer deposits. As discussed in the commission's response to Question 2, the commission finds that the use of a third party administrator is not cost-effective. The commission believes the approach it is adopting to protect customer deposits strikes the appropriate balance between cost concerns and protecting customer deposits.

Question 4: Given the current instability in the financial markets and the substantial differences in the collateral required for a subsection (f)(1)(A) REP versus a subsection (f)(1)(B) REP, does

the rule adequately address what happens if a REP suddenly moves from one category to another as a result of a credit downgrade?

OPC, TXU, Texas ROSE/TLSC, RCM, ARM, and TEAM stated that the rule does not address a REP downgrade from the access to capital requirements under subsection (f)(1)(A) to the requirements under subsection (f)(1)(B). The parties recommended grace periods ranging from 10 days to six months to allow a REP that no longer meets the requirements of subsection (f)(1)(A) to meet the requirements of subsection (f)(1)(B).

TEAM argued that the issue should be addressed by creating a level playing field, rather than adding transition time for a REP that experiences a financial status change.

Reliant asserted that the rule adequately addresses the situation of a REP being downgraded, noting that subsection (i)(3) requires a REP to notify the commission within three days of a material change, and subsection (j) provides for the suspension of a certificate.

OPC stated that the rule does not address what would happen to a REP under subsection (f)(1)(B) if it incurs a sanction or default.

Cities recommended less differentiation between subsections (f)(1)(A) and (f)(1)(B), and suggested that a letter of credit or escrow arrangement for customer deposits for all REPs would lessen the impact of a downgrade.

Texas ROSE/TLSC recommended that if a REP experiences a downgrade or its liquid capital falls below \$3 million, the REP should be required to report the change in financial status within five calendar days. ARM recommended modifications to subsection (i)(4) to better specify a process for re-achieving compliance with the financial requirements.

Commission Response

The commission agrees with OPC, TXU, Texas ROSE/TLSC, RCM, ARM, and TEAM that the proposed rule did not adequately address the impact of a credit downgrade or other event that result in a REP certified pursuant to subsection (f)(1)(A) needing to establish that it meets the requirements of subsection (f)(1)(B). The commission provides additional rule language in subsection (i)(4) to address this concern. Additionally, the commission is eliminating the collateral required of REPs certified pursuant to subsection (f)(1)(B) to secure TDU deposits, which dramatically reduces the impact of a credit downgrade.

The commission agrees with Cities that there should be less differentiation between the deposit protection requirements of subsections (f)(1)(A) and (f)(1)(B). As discussed in its response to Question 1, the commission believes that REPs certified under both subsections should have the option of using segregated cash accounts, escrow accounts, and irrevocable stand-by letters of credit.

The commission disagrees with TEAM that the issue of a downgrade from subsection (f)(1)(A) to subsection (f)(1)(B) should be addressed by creating a level playing field, rather than adding transition time for a REP that experiences a financial status change. The

commission believes that it is appropriate to give applicants several options for qualifying to operate as a REP, with respect to financial qualifications and protections for customer deposits. Presumably, TEAM’s idea of a level playing field implies that there would be a single standard for financial strength and protection of deposits. The commission believes that such an approach would require substantially higher levels of financial strength for applicants or more collateral and add costs to the market compared to the approach that the commission is taking in adopting the rule.

The commission agrees with OPC that the rule does not address what would happen to a REP under subsection (f)(1)(B) if it incurs a sanction or default. However, the commission finds that rule does not need to address this concern because the provisions in subsection (f)(1)(B) that used “sanction” or “default” have been deleted.

The commission agrees with Texas ROSE/TLSC that a REP should be required to promptly report a change in financial status. The commission is adopting a requirement that such a REP notify the commission within three working days pursuant to subsection (i)(4).

Question 5: Will our POLR and/or disclosure rules obviate the need for certain provisions of this rule? If so, please discuss the provisions and the impact that the other rules will have on the competitive market, REPs, and their customers.

ARM stated that addressing the issue of REP default on the “front end” in the certification rule should alleviate many of the concerns about POLR service that are being addressed in the POLR project. ARM emphasized that reducing the probability of REP defaults through new certification requirements will result in fewer instances in which POLR service is required. ARM added that it did not see a relationship between a new certification rule in this project and the REP disclosure rule.

OPC stated that the certification rule has a more significant impact on the market and consumers. OPC added that modifications to the certification rule would actually impact both the POLR and disclosure rules. OPC explained that the market begins with certification – and that the rule guides the standards for the caliber of entities that enter the market. Therefore, OPC opined that if a REP is sophisticated and has the tools necessary to succeed in this market, then it will, and the POLR rule will only be needed as “belt and suspenders” protection.

Texas ROSE/TLSC, OPC, and Joint TDUs stated that the proposed POLR rule would not obviate the need for a better REP certification rule. Texas ROSE/TLSC agreed with OPC on a “belt and suspenders” approach to further public protection. OPC also argued that the revisions to the certification rule are needed even if the proposed POLR rule is adopted. Joint TDUs stressed that even if the POLR rule mitigates the financial burden on customers transferred to the POLR, the process of transitioning customers is costly and disruptive to the market as a whole. Joint TDUs added that the market does not need to subsidize entrants who are not sufficiently equipped, financially and otherwise to support their own business risk.

Reliant commented that it is impossible to say whether certain provisions of this certification rule will or will not be necessary without knowing what provisions will or will not be adopted in the other pending rulemakings.

Conversely, Bounce stated that most issues addressed in this rulemaking can be resolved by the adoption of rules under the POLR rule. Bounce also stated that the revised POLR rule should include rapid transfer of customer accounts to and from their respective POLRs and ultimately to their desired REPs, clear and effective disclosures to customers affected by a REP insolvency so that customers can make timely and informed decisions, and reasonable price protections for the limited period necessary for customers to be transferred to the REP of their choice.

RCM agreed with Bounce and stated that it was the financial impact on customers being dropped to POLR, and the correspondingly higher electric rates, that led to the public outcry for change. NEM added that the parties should focus on reforming the POLR rule to protect consumers in the event of a default, and that it supports practical POLR rule modifications that concomitantly protect consumers and that allow robust marketer participation in the market to continue.

TEAM stated that many of the issues in the certification rule are under consideration in the Disclosure and POLR rulemaking projects. TEAM added that the changes proposed in the other rulemakings will eliminate the need for the certification rule to include modified financial requirements and increased reporting for REPs. TEAM recommended that the commission allow some experience with the other efforts and enhanced enforcement of existing reporting

requirements to take hold, before imposing new requirements that will increase the costs to provide service with no quantifiable benefit.

ARM stated that the adoption of financial, technical, and managerial requirements that aim to achieve a reduced probability of default is the best long-term solution for addressing the issues that triggered the contemporaneous initiation of the Certification and POLR rulemaking projects. ARM argued further that simply shifting an additional financial burden to those REPs obligated to provide emergency service is neither an effective nor equitable solution to the issues that the two rulemakings seek to remedy. ARM emphasized that it views emergency service as an integral component of the competitive electric market in Texas.

TEAM pointed out that the commission has recently taken other actions that will assist in avoiding the problems associated with market exits this past summer, such as the approval of advanced meter deployment. TEAM stated that these meters will allow REPs to better hedge against a volatile wholesale market through load control and possible participation as a demand resource.

TXU stated that there is a close relationship among the three rules, particularly between the POLR and the Certification rule. TXU believes the two rules most closely intersect with respect to the handling of customers' deposits. TXU argued that the fundamental policy tension between the Certification and POLR rules is the extent to which the commission provides customers additional protections by developing revised requirements for entry into the Retail market in the

Certification rule, as contrasted with enhancing customer servicing when their REPs fail, through the POLR rulemaking.

TXU stated that it is possible to appropriately raise the standards in the certification rule without making the barriers to entry too high, while also improving customer servicing in the POLR rule without making the costs and risks to REPs unmanageable.

RCM disagreed with ARM's comments and argued that ARM's attempt to encourage the commission to "raise the bar" is really an effort to significantly reduce the number of competitors in the market. Furthermore, RCM argued, ARM's reluctance to acknowledge the need for any changes to the POLR rule confirms that a "purge of REPs" is the preferred solution for ARM.

Commission response

The commission agrees that the disclosure rules have little impact on this rule and do not obviate any provisions in this rule. The commission recognizes the interrelationship between this rule and the POLR rule. The commission disagrees with TEAM that the changes proposed in the other rulemakings will eliminate the need for the certification rule to include modified financial requirements and increased reporting for REPs. It is the commission's intent to strengthen the quality of the REPs in the market so that fewer customers are transferred to POLRs as a result of REP defaults. The commission believes that by increasing the financial requirements and the technical and managerial requirements of REPs, fewer REPs will default. To the extent that some customers are

transferred to POLRs, the deposits will be secured. The POLR rules have not yet been finalized, but the commission does not believe that provisions in the POLR rule will obviate any part of this rule because this rule is designed, in part, to reduce the probability that a customer will be transitioned to a POLR, which is a purpose that cannot be addressed in a rule that is designed to address issues that are born after a transition to a POLR has occurred. The transfer to POLR can be made less traumatic for customers through changes in the POLR rule, but a REP failure results in customers losing the benefit of the service arrangements they have with a REP that fails. One of the objectives of this rule is to reduce the number of instances in which customers lose this benefit, by reducing the number of REP failures.

The commission disagrees with TEAM that advanced metering will fundamentally affect the technical, managerial, or financial qualifications needed to be an effective REP. In addition, advanced metering will not be fully deployed, nor will the systems be in place for REPs to utilize the meters in the manner that TEAM suggests, for some time. Therefore the commission does not change any of the qualifications in this rule as a result of TEAM's comment.

The commission disagrees with RCM's comment that ARM's attempt to encourage the commission to "raise the bar" is really an effort to significantly reduce the number of competitors in the market. Whatever ARM's motivations may be, the commission's objectives are to maintain vibrant competition in the retail market and improve customers'

experience in the market, and the commission does not believe that the rule will significantly reduce the number of competitors.

Question 6: General rate case principles require TDUs to prove that an expense is reasonable and necessary, in order to recover it. Is any additional language required in subsection (f)(3)(C) to make it clear what the TDU must prove in a rate case to obtain cost recovery of a regulatory asset related to REP bad debt?

OPC, Cities, Texas ROSE/TLSC, RCM, and SHELL stated that no additional language is necessary.

Joint TDUs recommended additional language to satisfy the auditors for creation of the regulatory asset and to make it clear that the regulatory review of reasonableness is required before rate recovery of the asset occurs.

Commission response

As discussed in connection with subsection (f)(3) below, the commission revises the language regarding the creation of a regulatory asset as suggested by Joint TDUs so that the utility's auditors will allow the utility to create a regulatory asset.

Question 7: Does PURA give the commission the authority to pre-approve the transfer of a REP certificate?

Texas ROSE/TLSC stated that the commission has the authority to pre-approve a transfer pursuant to PURA §39.352(a). PURA does not allow a person to conduct business as a REP unless the person has been certificated as a REP by the commission. The commission is required to approve a transfer to assure that the REP receiving customers meets the requirements of PURA and the commission's rules. TIEC expressed the same view and argument.

OPC stated that the commission may approve REP certificate transfers because such approval is reasonably necessary to carry out the express requirements of PURA §39.352(a). Without the ability to approve the transfer of REP certificates, the commission would not be able to fulfill its obligation to ensure that entities that provide retail electric service have been certificated by the commission. OPC also stated that a REP certificate transfer without customer consent or commission approval would be considered slamming under PURA §39.101(b)(2) and the commission's customer protection rules. Finally, OPC noted that the current rule requires prior approval by the commission of a REP certificate transfer, and that nothing in PURA has limited the commission's authority to require pre-approval since the last version of the rule was approved.

Cities stated that the authority to pre-approve the transfer of a REP certificate is implicit in the power of the commission to issue REP certificates pursuant to PURA §39.352. A REP certificate is issued based upon representations made by the applicant regarding its financial, technical, and managerial resources. A change in ownership is a material change in the representations upon which certification is based. Cities stated that the authority to amend or modify a certificate based upon a change in the circumstances underlying the initial approval is

inherent in the commission's power to issue certificates. Cities also stated that PURA §39.356(a) allows the commission to suspend, revoke, or amend a REP certificate for violations of the commission's rules. The proposed rule can require a REP to obtain approval of a modification to the certificate to reflect a change in ownership. In reviewing the modification, the commission can consider whether the change in ownership would affect the REP's financial or technical capability to provide continuous and reliable service. Cities stated that the express terms of PURA §39.356(a) permit the commission to revoke or suspend the certificate.

TXU stated that PURA allows the commission to require pre-approval where the certificate is acquired by an entity that has not previously provided retail electric service under the certification being transferred but does not allow the commission to require pre-approval where the transaction only results in a change in the direct or indirect owners of a REP. TXU further stated that the commission concurred with this limitation when it declined to require prior approval of direct or indirect transfers in Project Number 34309.

Reliant stated that no specific authority allows the commission to control the ability of a REP to transfer a certificate. In addition, the purchase of stock in a REP or its parent would not require a transfer, nor would the commission have the authority to approve or deny such a purchase. Reliant noted that the commission could decide that the purchaser of a REP certificate is not qualified to be a REP.

ARM stated that the commission lacks authority under PURA to regulate transactions of this nature, and that nothing in the statute authorizes the commission to approve the transfer of a REP

certificate. ARM stated that the as-filed version of Senate Bill 7 included a proposed PURA §39.158, which would have required a REP to obtain commission approval to merge, consolidate, or otherwise become affiliated with another REP. ARM noted that this provision was not included in the enacted version of the bill, and stated that the absence of the provision evinces a legislative intent to permit REPs to transfer certificates without commission approval. ARM also noted that the commission obtained authority in the last legislative session to approve sales, transfers, and mergers by electric utilities and TDUs and that the existence of this authority and the absence of similar authority applicable to REPs demonstrate legislative intent to allow the transfer of a REP certificate without commission approval. ARM mentioned that Chairman Smitherman filed two memoranda in Project No. 34039 contending that the commission lacked such authority under PURA. ARM stated that the commission's authority applies to whether a holder of a REP certificate meets the financial, technical, and managerial requirements in §25.107, and that the commission's authority over a sales/transfer/merger transaction involving the transfer of a REP certificate is limited in that respect. The transferee in such a transaction must meet the commission's certification requirements at the time of the certificate transfer or risk being in violation of §25.107. If a transferee is not already certificated to provide retail electric service in Texas, the transferee would need to obtain a REP certificate prior to or at the time of the transfer, and as a practical matter, the issuance of the certificate should take into account the pending certificate transfer as a way to ensure continued compliance with §25.107 once the certificate transfer takes place. According to ARM, if the transferee already holds a REP certificate, then proposed subsection (i)(3), as revised in ARM's comments, requires the REP to amend its existing certificate if the transfer involves a material change in the financial, technical, or managerial information upon which the REP and commission relied at the time the

existing certificate was issued. ARM also stated that its proposed revisions to subsection (i)(3) would permit a REP under such circumstances to amend its certificate prior to the closing of the transaction.

Joint TDUs stated that an incongruity exists between not allowing an entity to start a REP until it demonstrates compliance with the commission's rules and allowing that same entity to operate a REP through a certificate transfer without having to demonstrate compliance with the commission's rules. Joint TDUs noted that the proposed rule appropriately gives the commission the authority to more closely monitor the financial condition of REPs, and that the transfer, merger, or sale of a REP certificate should not be used to impede the commission's oversight. Finally, Joint TDUs stated that it is important for TDUs to have accurate information regarding who is financially responsible for delivery charges. Joint TDUs recommended that TDUs should receive notice of any transfer, and that the transferee must execute a Delivery Service Agreement with the TDU before being eligible for delivery service.

Commission Response

The commission finds that issues regarding the transfer of a REP certificate and changes in the control of REPs merit further discussion in a separate project to fully develop the issues surrounding the transfer of REP certificates and changes in the control of REPs, and to provide certainty to the market regarding these transactions.

Subsection (a)(4)

TXU stated that the prohibition against REPs owning and operating generation assets is not necessary and should be deleted.

Texas ROSE/TLSC supported the proposed rule provisions in subsection (a) through (e) as written.

Commission Response

The commission agrees with TXU that this provision is unnecessary because this prohibition is already contained in PURA §31.002(17). The provision is therefore deleted.

Subsection (b)(4) - Definition of guarantor, now (b)(7)

ARM and TXU recommended that the definition of “guarantor” be expanded to include an affiliate, and to require that a guarantor satisfy the financial requirements. In addition, TEAM proposed that the rule should allow guarantees by non-affiliates.

Commission Response

The commission agrees that it is unnecessary to limit the types of entities that can provide a guaranty agreement. The commission therefore expands the definition of guarantor to include any person providing a guaranty agreement, business financial commitment, or

credit support agreement providing financial support to a REP or applicant for REP certification pursuant to this section.

The commission disagrees with ARM and TXU that the definition of guarantor should require that the guarantor satisfy the financial requirements. The requirement that the guarantor satisfy the financial requirements is provided in subsection (f)(4)(G).

Subsection (b)(5) - Definition of investment-grade credit rating, now (b)(8)

Joint TDUs recommended adding language to the definition of “investment-grade credit rating” to allow ratings from A.M. Best and to remove the ambiguous reference to nationally recognized credit rating agencies.

Commission Response

The commission agrees with Joint TDUs. The commission expands the definition of investment-grade credit rating to include a “BBB” rating from A.M. Best, and removes the reference to nationally recognized agencies.

Subsection (b)(6) - Definition of liquid capital

Joint TDUs recommended adding clarifying language to the definition of “liquid capital” to exclude customer deposits, deposits with the TDU, and other restricted or encumbered cash.

ARM suggested additional language to acknowledge that a REP can rely on a guarantor to demonstrate or to help demonstrate liquid capital. Reliant expressed concern about ARM's suggestion and noted that guaranty agreements, corporate commitments, and credit support agreements are not liquid capital.

TEAM agreed with Shell that the commission should allow a REP that has a lock box credit arrangement with its wholesale supplier to count that credit toward its financial resources to allow small REPs that cannot meet the proposed financial standards to continue providing service to their retail customers in Texas. Joint TDUs argued that Shell's proposal is problematic because of the difficulty in valuing the arrangement, and because the funds are in a lock box controlled by Shell and are not liquid and unencumbered.

Commission Response

Because of changes to subsection (f), the commission finds that the definition of liquid capital is no longer relevant. The definition of liquid capital is deleted.

Subsection (b)(7) - Definition of permanent employee, now (b)(9)

ARM stated that proposed subsection (g)(1)(F) is critical to reducing the probability of a REP default, but that the definition of "permanent employee" failed to fully capture the objective of that section, which is to integrate commodity risk management and hedging expertise into a REP's business structure. ARM stated that to the extent that a REP's intention to employ someone for at least six months is subjective, it will be difficult to prove or disprove. ARM

stated that an objective demonstration of the REP's commitment to integrate commodity risk management and hedging expertise on a permanent basis is the better option. ARM suggested that the definition distinguish a permanent employee from a consultant, third party contractor, temporary employee or other individual who is not fully and permanently integrated into the REP's business organization. ARM also suggested that the sixth month period should be deleted and that the proposed definition should be expanded to further define a permanent employee in the negative.

Commission response

The commission agrees with ARM that intent to hire someone for six months is subjective and that a better option is to require an individual that is fully integrated into the business organization and is not a consultant. Therefore the commission makes changes to the definition of permanent employee to refer to an individual that is fully integrated into the business organization and is not a consultant.

Subsection (b)(8) - Definition of person, now (b)(10)

Commission Response

The commission finds that the definition of person should be broadened for purposes of this section to include all types of business entities, while maintaining the exclusion for an electric cooperative or municipal corporation as required by PURA, because the proposed rule did not provide for a limited liability company.

Subsection (b)(11) - Definition of sanction

ARM stated that the definition of the term “sanction” should be removed from the rule. ARM stated that the definition differs from the common meaning of the term, which is a penalty or coercive measure that results from failure to comply with a law, rule, or order. A sanction is the punishment that follows a finding of a legal violation; it is not the violation itself or a finding of a violation. ARM noted that the term sanction is only used in subsections (f)(1)(B)(ii) and (iii), which provide that a REP must have access to \$2 million or \$1 million in liquid capital if it has operated in the Texas market without default or sanction for two or three years, respectively. ARM stated that definition of sanction is important for REPs that must demonstrate access to liquid capital pursuant to subsection (f)(1)(B). ARM also stated that the definition of sanction includes all commission findings of violations of law in its final orders. Thus, a finding of a violation of a minor commission procedural rule would be on par with a finding of a violation of an ERCOT Protocol with multi-million dollar consequences. Finally, ARM stated that the sanction under the proposed rule does not have to relate to the REP’s financial health or conduct.

TXU agreed with ARM’s proposal to delete the definition of the term “sanction.”

Commission Response

The commission has deleted the definition for “sanction” because the adopted rule does not use that term.

Subsection (b)(12) - Definition of tangible net worth, now (b)(14)

TXU, Reliant, and First Choice opposed a net worth calculation that subtracts goodwill and intangibles. TXU argued that the definition of tangible net worth improperly excludes consideration of goodwill and other intangible assets that have significant value in the marketplace. Joint TDUs and OPC stated that intangibles should not be included in a net worth calculation because of the difficulty in valuing the intangibles. OPC noted that goodwill cannot reimburse customers or offer any tangible assistance to customers in the event of default.

Commission Response

The commission agrees, in part, with TXU, Reliant, and First Choice. The commission modifies the definition of tangible net worth such that tangible net worth equals total shareholders' equity, determined in accordance with generally accepted accounting principles, less intangible assets other than goodwill. The commission allows goodwill because of changes to accounting standards that add transparency to the valuation of goodwill and that require that REPs use mark-to-market rules in valuing certain assets that may have a significant impact on the value of goodwill and, consequently, the REP.

Subsection (c)

ARM stated that the proposed rule lacks clarity as to how REPs currently holding certificates are to comply with the new certification standards adopted in this proceeding. ARM indicated that a statement regarding REP compliance with these new certification requirements is important because the commission is repealing the current certification rule with which those REPs have

complied to date. ARM provided a modification to subsection (c)(1) to better capture the continuing application of the certification requirements to REPs, in particular, the financial requirements.

ARM stated that the subsection (c)(2) requirement that an application for certification be signed by a principal is both inappropriate and impractical. ARM argued that a principal, such as a controlling shareholder, is not always intimately involved in the applicant's day-to-day business and may not serve on its behalf in any representative capacity. Consistent with current certification practice, an officer of the applicant should bear the responsibility of vouching for the content of the submitted certification application.

ARM suggested that subsection (c)(3) be rewritten to allow for the filing of confidential information. TXU and Reliant agreed with and supported ARM's suggestion for subsection (c)(3).

Commission Response

The commission agrees with ARM that the proposed rule lacked clarity as to how REPs currently holding certificates are to comply with the new certification standards. The commission adds rule language in subsection (k) to establish a phase-in period for existing REPs to establish compliance with all of the new certification standards, and modifies language in subsection (f)(1)(B)(iii) to identify existing REPs that are required to meet the shareholders' equity requirement under subsection (f)(1)(B).

The commission agrees, in part, with ARM's recommendation to replace "principal" with "officer" in the affirmation of an application for certification. The principals of an applicant for certification may not necessarily have day-to-day involvement with the applicant's business operations, and it may be impractical to secure the required affirmation from a principal. The commission replaces "principal" with "executive officer" in subsection (c)(2), and provides a definition of executive officer in subsection (b).

The commission agrees, in part, with ARM, TXU, and Reliant that the rule should address the filing of confidential information. The commission did not intend the deletion of former section (c)(4) to alter the right of a REP to file information confidentially as allowed by law. Subsection (i)(8) of the proposal for publication required that all applications, reports, and notifications required by this section be filed in accordance with the commission's procedural rules, which address confidential filings in §22.71(d). The commission does not believe that additional language regarding the filing of confidential documents is needed because the commission's procedural rules and the standard protective order provide sufficient procedures for the handling of confidential documents. The commission does believe, however, that the reference to the procedural rules should be moved to subsection (a) to make it clear that the language applies generally to documents filed pursuant to this section.

Subsection (d)

TIEC stated that clarification needs to be made that an Option 2 REP that serves its parent company may continue the existing practice of submitting a consolidated financial report with that parent. TIEC concluded that producing a separate financial report for the REP would unnecessarily and excessively increase the administrative burden and costs of becoming an Option 2 REP, as it would require significant accounting and organizational changes.

NEM and RCM proposed that the commission relax and/or expand the Option 2 requirements to allow very small REPs to serve particular niche markets (limited by number of customers or aggregate load served) without otherwise satisfying all of the financial and technical requirements for subsection (f) and (g). NEM and RCM suggested that the new REP financial, technical and managerial requirements are onerous and will discourage new REP entrants. Further, NEM and RCM contended that the commission should consider relaxing these requirements to assist and encourage smaller REPs, who are bringing to market some of the most innovative products, but want to grow slowly.

NRG opined that PURA does not require Option 2 REPs to demonstrate specific financial or technical requirements to the commission in order to be certificated and that imposing specific financial requirements on Option 2 REPs would be inconsistent with PURA §39.352(d), and would undermine the commercial flexibility that is a primary motivation for becoming an Option 2 REP.

Commission Response

The commission agrees with NRG that PURA §39.352(d) does not require any specific financial or technical requirements and that imposing specific financial requirements on Option 2 REPs undermines the commercial flexibility of the option. The commission concludes that REPs certified pursuant to PURA §39.352(d) need not provide financial reports. Based on this change, the TIEC argument is moot.

The commission disagrees with the NEM and RCM proposal that the commission should relax or expand the Option 2 requirements. The commission finds that the NEM and RCM proposal is inconsistent with the requirements of PURA §39.352(d). The commission finds that the NEM and RCM proposal, if presented as a load-restricted option under Option 1, would differ from Option 2 in terms of the commission resources and the practicality of policing the compliance of the REP, and would increase the burden on commission resources and the risk of harm to customers.

Subsection (e)

ARM proposed two changes for subsection (e)(2), regarding office requirements. ARM contended that the Texas office required by PURA §39.352(b)(4) did not need to be the exclusive location for the three required functions: customer service provision, acceptance of service of process, and maintenance of sufficient records to demonstrate compliance with PURA and commission rules. ARM argued that Texas law allows acceptance of service of process through a registered agent that may be at a separate address. In addition, ARM also argued that

the REP must be given reasonable advance notice of any commission staff office visit to allow the REP time to ensure the availability of the records being sought for review and to provide any necessary personnel to assist in the review.

Commission Response

The commission agrees with ARM that, to the extent that the Texas office listed in the application will accept service of process as well as provide the other functions required, these functions can also occur at other offices as well. However, to the extent that ARM is suggesting that one or more of these functions do not occur at this office, the commission finds that circumstance unacceptable, because PURA §39.352 states that the REP must demonstrate “ownership or lease of an office located within this state *for the purpose of providing customer service, accepting service of process, and making available in that office books and records sufficient to establish the retail electric provider’s compliance with the requirements of this subchapter.*” (Emphasis added.) Given these requirements and the commission’s authority to investigate whether these functions are occurring at the premises, the commission declines to require itself to notify the REP in advance of a visit to investigate, as the records the commission staff are seeking should be available at that office under the statute.

Subsection (f)(1), generally

Joint TDUs, ARM, OPC, Texas ROSE/TLSC, Cities, TXU, Reliant, OAG, and FCP supported the commission’s effort to establish more stringent financial requirements for REPs. Texas

ROSE/TLSC stated that the proposed rule will improve the financial stability of REPs and restore consumer confidence in the market, and supported the provisions requiring an investment-grade credit rating, \$100 million in tangible net worth, or liquid capital in excess of \$3 million for financial qualification. First Choice stated that the proposed rule strengthens the certification requirements for REPs in a manner that provides adequate protection for customers, TDUs, and REPs without creating unnecessary barriers to entry. ARM indicated that it is opposed to any significant revisions to the proposed subsection (f)(1).

NEM, En-Touch, Tara, and TEAM are opposed to increasing the financial requirements, arguing generally that the financial requirements are unreasonably burdensome to small REPs and present a substantial barrier to entry. RCM agreed that the financial standards are burdensome as proposed, but disagreed with parties that advocate maintaining the status quo.

Regarding the different criteria outlined in subsections (f)(1)(A) and (f)(1)(B), TXU agreed with the commission's effort to establish separate criteria for REPs based on creditworthiness. TXU argued that it is the most cost-effective way of protecting all stakeholders. Integrys, Constellation, and Direct noted that an investment-grade credit rating is applied appropriately in the rule because it represents a lower probability of default that allows an entity engage in commercial transactions with no security or less security compared to an entity that does not have an investment-grade credit rating.

RCM and Bounce opposed the establishment of separate criteria for financial qualification. Bounce proposed that all existing REPS that are serving retail customers should be subject to

subsection (f)(1)(B)(iii), which requires liquid capital in excess of \$1 million. Under the assumption that this argument has merit, Cities proposed that the argument does not necessarily support a uniform \$1 million requirement, and that the argument may lead to the conclusion that \$2 million or \$3 million is the appropriate level. Alternatively, Bounce suggested that the impact of subsection (f)(1)(B) would be less discriminatory if the new liquid capital requirements were applied only to new REPs, since these REPs would have full disclosure of the requirements.

ARM suggested that the financial requirements should be modified to contemplate more than one guarantor, and noted that the proposed rule does not indicate whether the guaranty or commitment of a guarantor is open-ended or for a specific amount. ARM suggested that the amount guaranteed should correlate to one of the liquid capital requirements. TXU suggested that the REP demonstrate that it can access capital from the guarantor in an amount sufficient to satisfy subsection (f)(1)(B) and subsection (f)(2).

Commission Response

The commission disagrees with NEM, En-Touch, Tara, and TEAM that the financial requirements are unreasonably burdensome to small REPs and present a substantial barrier to entry. The commission agrees with First Choice that the proposed rule strengthens the certification requirements for REPs in a manner that provides adequate protection for customers, TDUs, and REPs without creating unnecessary barriers to entry.

The commission disagrees with Bounce that all existing REPS that are serving retail customers should be subject to proposed subsection (f)(1)(B)(iii), which requires liquid

capital in excess of \$1 million. The commission believes that the financial requirements should be bifurcated based on creditworthiness, and agrees with TXU that such an approach is the most cost-effective way to protect all stakeholders.

The commission agrees, in part, with Bounce that the new liquid capital requirements should be applied only to new REPs, since these REPs would have full disclosure of the requirements. The commission provides rule language in subsection (f)(1)(B)(iii) that exempts REPs that served load on or before January 1, 2009 from the requirement to demonstrate the shareholders' equity required by subsection (f)(1)(B).

Subsection (f)(1)(A)(i)

TXU agreed that an investment-grade credit rating is an appropriate standard because investment-grade companies are generally financially reliable and possess adequate liquidity to meet near-term obligations. Additionally, TXU invited the commission to consider a good payment history of 24 months as a means of qualification under subsection (f)(1)(A). Joint TDUs and RCM recommended that the commission reject TXU's proposal and argued that 24 months of good payment history with the TDU is not a substitute for an investment-grade credit rating.

Joint TDUs recommended that the credit ratings should be one notch above investment grade. Integrys, Constellation, Direct and TXU opposed Joint TDUs' recommendation because it increases the standard beyond what Moody's and S&P define as investment grade.

Commission Response

The commission agrees with TXU that an investment-grade credit rating is an appropriate standard for demonstrating the financial ability to obtain and maintain REP certification because companies with investment-grade credit ratings are financially reliable and possess adequate liquidity to meet near-term obligations.

The commission disagrees with TXU and agrees with Joint TDUs and RCM that a good payment history is not a substitute for an investment-grade credit rating. An investment-grade credit rating establishes a much higher standard for creditworthiness compared to a good payment history.

The commission disagrees with Joint TDUs that the credit rating should be one notch above investment grade. The commission agrees with Integrys, Constellation, Direct and TXU that Joint TDUs' recommendation increases the standard beyond what Moody's, S&P, Fitch, and A.M. Best define as investment grade.

Subsection (f)(1)(A)(ii)

TXU generally supported the use of net worth and financial ratios in subsection (f)(1)(A)(ii), but recommended that intangibles should be included in the net worth calculation. Additionally, TXU recommended removal of the current ratio because of the accounting mismatches between current assets and current liabilities. TXU agreed with Reliant that subsection (f)(1)(A)(ii)

should include language to clarify that the effects of derivatives should be excluded from the calculation of the debt-to-total capitalization ratio.

Joint TDUs recommended that subsection (f)(1)(A)(ii) be deleted. Alternatively, Joint TDUs recommended additional language to subsection (f)(1)(A)(ii) that would require positive cash flow from operations for the most recent six months. TXU and Reliant opposed Joint TDUs' proposal to eliminate subsection (f)(A)(ii), and stated that the provision provides reasonable assurance of a REP's creditworthiness and limits risk to the TDU. Additionally, TXU and Reliant opposed the inclusion of a positive cash flow requirement because of the seasonal affects on cash flow.

Commission Response

The commission agrees with TXU and Reliant that the calculation of tangible net worth in subsection (f)(1)(A)(ii) should account for the effects of derivatives. The commission finds that a significant portion of the market value of the REP business is based on the mark-to-market value of contracts and financial instruments used to procure wholesale electricity or to hedge the cost of wholesale electricity. The commission modifies rule language in subsection (f)(1)(A)(ii) to account for unrealized gains and losses that result from marking to market such contracts and instruments, provided that the contracts and instruments are for the purpose of serving load.

The commission disagrees with TXU regarding the removal of the current ratio criteria. The commission understands TXU's concern regarding the potential for accounting

mismatches between current assets and current liabilities. However, the commission finds that a current ratio of not less than 1.0 is a low hurdle, and that a REP qualifying under subsection (f)(1)(A)(ii) should at least be able to demonstrate that it has sufficient current assets to meet its current obligations.

The commission disagrees with Joint TDUs that subsection (f)(1)(A)(ii) should be deleted. The commission rejects Joint TDUs alternative recommendation modifying subsection (f)(1)(A)(ii) to require positive cash flow from operations. The commission agrees with TXU and Reliant that subsection (f)(1)(A)(ii) provides reasonable assurance of a REP's creditworthiness, and that the positive cash flow requirement should not be included because of the seasonal effects on cash flow.

Subsection (f)(1)(B)

Bounce, NEM, OPC, REPower, TXU, Texas ROSE/TLSC, RCM, TEAM, and Shell stated that the liquid capital requirements should not be based on the number of years that a REP has continuously served customers, and offered a variety of alternatives that scale the liquid capital requirement based on load or customers.

RCM argued that a REP has no material financial obligations when initially entering the market because it has no customers or forward supply purchases. RCM suggested that the need for capital increases as the business grows. RCM recommended that the initial liquid capital requirement be set at \$300,000 and that the ratio between TDU billings and liquid capital in the

current rule be increased from 40% to 60%, with a maximum requirement of \$1 million. TEAM generally agreed with RCM, but recommended an initial threshold of \$250,000 and a scale up to \$1 million.

REPower agreed with the commission that liquid capital requirements should be set to a reasonable level to ensure that a REP has ready access to funds necessary to meet unexpected requests for collateral. REPower recommended liquid capital of not less than two times the ERCOT collateral requirements not to exceed \$1 million.

OPC argued that the liquid capital requirements should be scaled to the amount of load, such that REPs demonstrating liquid capital between \$2 million and \$4 million are load restricted on a sliding scale. Under OPC's plan, REPs that meet the requirements of subsection (f)(1)(A) may serve an unlimited amount of load. Reliant generally agreed with OPC's proposal of a stair-stepped approach based on load but noted that the approach did not include specific amounts of load. Reliant suggested that parties be given an opportunity to comment on the load thresholds should the commission choose to pursue the idea.

ARM and Joint TDUs disagreed with all commenters that proposed scaling the capital requirements based on load or customers. ARM argued that scaled requirements are unnecessary because REPs are already subject to ERCOT credit requirements and to counterparty credit requirements relating to bilateral wholesale power arrangements that are based on load. ARM noted that a scaling requirement will likely result in the frequent need to revise the financial instrument upon which the REP relies to meet the financial requirements. ARM pointed out that

the objective of the rule is to reduce the probability of REP default, and that the rule should more simply reflect that the REP has access to a sufficient level of financial resources to enter and operate in the market, rather than attempt to match the financial requirements with the REPs exposure to the market. Joint TDUs argued that the purpose of the requirement is to establish that a new REP is financially stable *before* it acquires new customers, such that the PUC can advertise the REP on the Power to Choose website with confidence that the REP will be able to stay in business and serve any customers it attracts.

Cities argued that most commenters missed the rationale for the liquid capital criteria. Cities stated that the threshold is intended to weed out fly-by-night REPs, and that a REP that can raise the amount of liquid capital required by the rule is less likely to be a transient. Cities stated that scaling the requirement to load or customers is not an unreasonable idea, but argued that the floor of such a scale should remain \$1 million.

TXU suggested that the \$3 million liquid capital requirement might be too low. TXU proposed that REPs that cannot meet the requirements of subsection (f)(1)(A) should be required to provide a cash deposit or a LC to the commission to ensure that the REP is committed to fulfilling its obligations. The deposit or LC would be returned to the REP upon exiting the market net of costs associated with customers being dropped to POLR. Should the REP fail, the deposit or LC would be used to offset the cost of providing POLR service and to defray the customers' loss of the benefit of the bargain with the failing REP.

Shell and RCM argued that the liquid capital requirement as proposed is dead capital that the REP can't put to work in its business because the use of it would result in a violation of the rule. Similarly, Tara argued that the liquid capital requirement is a reservation of assets that may not be used or borrowed against, and that it provides an advantage to the largest REPs. RCM suggested that the rules should permit the use of the funds after a trigger event and provide a reasonable amount of time to rebuild the funds after a trigger event.

Commission Response

The commission agrees with Bounce, NEM, OPC, REPower, TXU, Texas ROSE/TLSC, RCM, TEAM, and Shell that financial qualification pursuant to subsection (f)(1)(B) should not be based on the number of years that a REP has continuously served customers. The commission disagrees that such a qualification should be based on load or customer count. The commission agrees with ARM that the objective of the rule is to reduce the probability of REP default, and that the rule should more simply reflect that the REP has access to a sufficient level of financial resources to enter and operate in the market, rather than attempt to match the financial requirements with the REP's exposure to the market. The commission agrees with Joint TDUs that the purpose of the requirement is to establish that a new REP is financially stable before it acquires new customers. The commission agrees with Cities that a REP that can raise the amount of capital required by the rule is less likely to be transient. The commission finds that the objective of subsection (f) is to establish the financial requirements to obtain and maintain REP certification, and that the credit risk associated with the scale of each REP's business should continue to be managed by

agreements between the REP and ERCOT, or the REP and its counterparties that provide wholesale electricity.

The commission agrees with TXU that REPs that cannot meet the requirements of subsection (f)(1)(A) should be required to provide a cash deposit or a LC to the commission to ensure that the REP is committed to fulfilling its obligations. The commission finds that REPs that cannot meet the requirements of subsection (f)(1)(A) shall provide and maintain a LC payable to the commission. The commission modifies rule language in subsection (f)(1)(B) to require the LC, and provides rule language in subsection (f)(6) regarding the use of proceeds from a LC. The commission believes that the LC increases the probability that a REP will unwind its business in a manner that will avoid market defaults and lead to the return of proceeds from the LC to the REP. However, if the REP experiences a mass transition of its customers by ERCOT, then the LC provides a source of cash that is available for disbursement by the commission to pay POLR deposits for low income customers, mitigate losses incurred by other customers, ERCOT, or TDUs, or for the payment of administrative penalties.

The commission agrees, in part, with Shell and RCM that the liquid capital requirement as proposed is “dead capital” that the REP cannot put to work in its business because the use of it would result in a violation of the rule, and that the rule should permit the use of the funds after a trigger event. The commission finds that the liquid capital requirement under subsection (f)(1)(B) should be deleted and replaced with a requirement to demonstrate shareholders’ equity of one million dollars that the REP can put to work in its

business without a violation of the rule, provided that the REP does not make any distributions to shareholders or affiliates that will result in shareholders' equity of less than one million dollars for a period of not less than two years after REP certification. The commission finds that the requirement to demonstrate shareholders' equity strikes the appropriate balance regarding the appropriate amount of capital to obtain certification, and that the related restriction on distributions to shareholders provides certainty to the commission that the demonstrated shareholders' equity will be invested in the REP.

Subsection (f)(1)(C)

ARM noted that the compliance process in subsection (f)(1)(C) lacks specificity. ARM provided substantial language that it believes will eliminate confusion for REPs seeking to comply with the new certification standards. Joint TDUs agreed with ARM and added that a new application for certification should be submitted by a REP if it finds during the winding down process that it can comply with the new requirements.

Regarding the period of time provided under subsection (f)(1)(C) to comply with the new financial requirements, Bounce, REPower, Tara, and Shell argued that the period of time should be lengthened from six months to as much as 18 months. Texas ROSE/ TLSC, Joint TDUs, and ARM proposed that the period of time provided under subsection (f)(1)(C) to comply with the new financial requirements should be reduced from six months to as little as 60 days. Joint TDUs recommended that the period of time should be shortened so that REPs come into

compliance prior to the 2009 summer months. TXU disagreed and argued that the 180 days proposed by the rule is reasonable.

TXU, ARM, and Reliant suggested that the commission make clear by rule that information submitted pursuant to this rule shall be treated confidentially if such treatment is requested by the REP. Each specifically suggested that the related provision in the existing rule be reinstated.

Commission Response

The commission finds that subsection (f)(1)(C) of the proposed rule, which applied to the financial requirements of subsection (f)(1) only, should be deleted. The commission is adopting subsection (k) to establish a phase-in provision that applies to all of the requirements of new §25.107.

The commission agrees, in part, with Bounce, REPower, Tara, and Shell that the period of time to comply with the financial requirements should be lengthened. The commission finds that six months may not be enough time to comply.. Subsection (k) provides 12 months to comply with all requirements of new §25.107.

Subsection (f)(2)

ARM, TEAM, OPC and Reliant stated that all REPs should be treated equally regardless of whether the REPs were certified pursuant to proposed subsections (f)(1)(A) and (f)(1)(B). ARM, TEAM, OPC and Reliant advocated collapsing proposed subsections (f)(2)(A) and (f)(2)(B) into

one provision, so that all financial instruments referenced in both provisions are included in a single provision applicable to all REPs serving residential customers. ARM also proposed adding the use of a guaranty or commitment from a guarantor with an investment-grade rating and a credit support agreement to the universe of financial instruments that can be used for this purpose.

OPC stated that Texas ROSE/TLSC, in their comments to Question 1, added an important element to subsection (f)(2) that “not only should customer deposits be protected, but there should be a like assurance regarding any advance payments that customers may have paid for pre-pay service.” OPC agreed with Texas ROSE/TLSC and believes the requirement of REPs to protect customer deposits is perhaps “the most important element of this rule.”

TXU proposed that the commission follow two steps regarding the protection of customer deposits. First, TXU stated that for a subsection (f)(1)(B) REP the commission immediately draw on the LC or account required of a subsection (f)(1)(B) REP in the event of a default by that REP. TXU stated that as customers are transitioned to a POLR, their proceeds could be allocated to the POLR. The POLR would then return the customer deposits to the customers, as appropriate, in a manner compliant with §25.478. TXU stated that the immediate draw on the LC or account provides an efficient way of returning customer deposits, obviates the need for customers to post additional deposits with POLRs, and provides POLRs with protection against non-payment from transitioned customers. TXU recommended that, for subsection (f)(1)(A) REPs who have not been required to post a LC or specific account, the commission prohibit the application by those REPs of deposits to customer bills except where the customer’s payment is

past due, the customer has switched or moved, or with the customer's express permission. TXU stated that in the event of a REP failure, the REP's ability to apply a deposit to the customer's bill under §25.478(j) should be revoked unless the REP has otherwise secured the return of the customers' deposits. Under §25.478, a REP is allowed to apply the customer deposits held by the REP (including interest) to the customer bills once the REP is no longer the REP of record for the customer. TXU stated that the failing REP should be required to provide the deposits to the customer's POLR, who will then return it to the customer in compliance with §25.478. Second, TXU stated that failing REPs should be required to provide a letter to the customer stating the time period during which the individual has been a customer of the REP, and that the customer is not delinquent in payment of any such electric service account and was not late in paying a bill more than once during the last 12 consecutive months of service. TXU stated that this letter could be used to satisfy the requirements of creditworthiness used by some REPs in assessing deposits to new customers. TXU stated that making compliance a prerequisite to seeking payment of outstanding bills seems more likely to adduce compliance from a failing REP than simply allowing failing REPs to pocket deposit money and disappear. Reliant agreed that the deposits held by a failed REP should be returned to the customer. Although Reliant was not opposed in concept to TXU's proposal to convey the deposit directly to the POLR, Reliant questioned how §25.478 should be applied in situations where the deposit is transferred from the failing REP to a POLR. Reliant noted that with multiple POLRs and various scenarios that could occur with a failing REP, the proposal would be difficult to implement, as there would be many administrative details that would have to be worked out to make sure the deposit follows the customer.

TXU noted that the interest rate for customer deposits for 2009 is set at 2.0%, and that the expense to secure a LC could cost as much as 3 or 4 percent. TXU recommended that all REPs use a restricted cash account and suggested the inclusion of specific language that describes the restrictions to be applicable to such an account.

TXU stated that the commission should allow subsection (f)(1)(A) REPs to use other commission approved instruments that provide an adequate level of protection of customer deposits and advanced payments.

The OAG stated that neither the existing rule nor the proposed rule distinguishes between “deposits” and “advance payments” in terms of how customer interests are protected. The OAG mentioned that the two classes of payments represent two different business models, each with different risks to customers when a REP fails. The OAG associated “deposits” with customers of REPs that pay for power after the use of it, wherein the REP collects a security deposit in order to reduce its risk in the event that the customer posting the deposit fails payment. The OAG associated “advance payments” to customers of REPs that pay for service in advance, creating a debt that the REP owes to its customer until such time as the customer uses the power that was purchased. The OAG stated that the commission could require that prepay REPs provide their customers with a “security deposit” to assure that this debt to their customers can and will be paid in the event of a REP’s withdrawal from the marketplace, thus becoming a trustee for their customers. Finally, the OAG suggested the possibility of using LCs or surety bonds as a means of assuring customers property is returned to customers.

ARM and TXU recommended that subsection (f)(2) apply only to residential customers. OPC opposed ARM's proposal that subsection (f)(2) apply only to residential customers and not protect the deposits or prepayments of small commercial customers.

REPower agreed with the OAG that the terms "deposit" and "advance payment" be defined to better specify the protection this rule provision is attempting to deliver.

REPower stated that the requirements contained in subsection (f)(2)(A) and (B) do not address the conditions faced by REPs operating under §25.498 and that there is not one specific point in time where a REP providing prepay service could set aside 100% of the "advance payment." REPower stated that prepay customers make an average payment of less than \$25 to purchase less than one week's worth of electricity, and that the average customer exposure would be far less than the amount of a deposit obtained from a REP providing traditional service. REPower suggested that a separate provision be included for REPs operating under §25.498.

REPower stated that by establishing a timeline for the refunds of any outstanding prepay amounts, the REP's failure to issue such refunds would be in violation of this rule and subject to commission enforcement.

Reliant disagreed with REPower that there should be a separate provision for prepayments pursuant to §25.498 and suggested that subsection (f)(2) be amended to make it applicable to prepayments as well.

Reliant suggested that REPs reconcile their restricted cash accounts on a monthly basis rather than be required to have sufficient funds to cover 100% of the REPs outstanding customer deposits and advance payments at all times. OPC opposed this idea because REPs would not be responsible to each of their customers at any point in time.

Commission Response

The commission disagrees with ARM, TEAM, OPC, and Reliant’s suggestion that all REPs should be treated equally under subsection (f)(2) regardless of whether the REPs were certified under subsection (f)(1)(A) or (f)(1)(B). The commission finds that it is appropriate to require more stringent requirements for the protection of customer deposits for REPs that do not meet the high standard for credit quality under subsection (f)(1)(A).

The commission agrees with OPC and Texas ROSE/TLSC that, not only should customer deposits be protected, but there should be like assurance regarding any advance payments that customers may have paid for pre-pay service. The commission modifies rule language in subsection (f)(2) to provide protection for residential advance payments.

The commission disagrees with TXU that deposits held by a failed REP should be conveyed directly to the customer’s new POLR provider, such that the POLR provider can return the deposit to the customer in accordance with §25.478. The commission finds that the transfer of deposits from one REP to another is problematic in terms of practical application. Instead, the commission has included subsections (f)(6)(A)(i) and (ii), which provide that the funds drawn from a REP’s letter of credit will first be used to pay POLR

deposits for low income customers. This approach can be implemented quickly and will provide a significant benefit to the customers who are likely to be most adversely affected by the REP's failure.

The commission agrees with OAG that the proposed rule does not distinguish between deposits and advance payments. The commission modifies rule language in subsection (f)(2) to make it clear that REPs are required to secure both deposits and advance payments. The commission believes that the requirements of subsection (f)(2), when paired with the requirements of subsection (f)(1) provide "belt and suspenders" protection for customer deposits and advance payments.

The commission disagrees with OAG that REPs offering pre-paid services should provide a security deposit to customers. The commission finds that such a security deposit would defeat the purpose of an effective prepaid program.

The commission agrees, in part, with ARM and TXU that subsection (f)(2) should only apply to residential customers. The commission finds that commercial and industrial customers are sophisticated counterparties that are capable of managing their counterparty risk, and that commercial and industrial customers often provide an advanced payment to obtain a bargain from the REP. The commission modifies rule language in subsection (f)(2) to limit the application of subsection (f)(2) to customer deposits and residential advance payments.

The commission agrees with REPower that the requirements contained in subsections (f)(2)(A) and (B) do not address the conditions faced by REPs operating under §25.498, and that a separate provision be included for REPs operating under §25.498. The commission provides rule language under subsection (f)(2)(C) to accommodate REPs that provide electric service under §25.498.

The commission disagrees with OPC and agrees with Reliant that REPs should be allowed to reconcile accounts that hold customer deposits and advance payments on a monthly basis, rather than be required to have sufficient funds to cover deposits and advance payments at all times. The commission finds that a monthly reconciliation, rather than a daily reconciliation, is a more efficient and effective way to manage funds that are required to be deposited in an escrow account or segregated cash account.

Subsection (f)(3)

Bounce, TXU, Tara, RCM, ARM, TEAM, Shell, and First Choice supported the creation of a regulatory asset to recover bad debt arising from REP defaults. Tara indicated its support for the concept, but argued that it is not properly noticed and is beyond the scope of this project. Joint TDUs disagreed with Tara's position that the regulatory asset provision is not properly noticed and is beyond the scope of this project.

Joint TDUs recommended language to satisfy audit standards and make it clear that the regulatory asset is to be reviewed for reasonableness before it is included in rates. Reliant opposed the additional language, arguing that the language is unnecessary.

ARM and Reliant suggested language to make it clear that the regulatory asset must be adjusted for bad debt charges that are already being recovered through delivery charges. Joint TDUs opposed ARM and Reliant's language regarding the potential for double recovery and proposed that the rate case is the appropriate forum to deal with the issue.

TXU, Joint TDUs, Tara, RCM, TEAM, Shell, and First Choice opposed the requirement to pay deposits under subsection (f)(3)(B). If the commission chooses to adopt the provision, then the parties recommend that the deposit requirement be specifically and clearly set forth in the rule. Joint TDUs recommended adopting language regarding the size of the required deposit and other terms, noting that it would be more efficient to establish the language in the REP rule than to amend the standard tariff. Additionally, Joint TDUs recommended language in subsection (f)(3)(A) to make it clear that a TDU's ability to collect a deposit from a REP that has defaulted still applies.

Commission Response

The commission finds that the requirement to pay deposits to protect TDU financial integrity is economically burdensome for all REPs. The commission agrees with Joint TDUs that subsection (f)(3)(A) should make it clear that TDUs may continue to collect a

deposit from a REP that has defaulted. The commission deletes subsection (f)(3)(B) of the proposed rule and modifies rule language in subsection (f)(3)(A) accordingly.

The commission agrees with Bounce, TXU, Tara, RCM, ARM, TEAM, Shell, and First Choice that the rule should allow the creation of a regulatory asset to recover bad debt arising from REP defaults, and finds that the regulatory asset provision is the most cost-effective method to protect TDU financial integrity.

The commission agrees with Joint TDUs' recommended language to satisfy audit standards and make it clear that the regulatory asset is to be reviewed for reasonableness before it is included in rates. The commission modifies rule language in subsection (f)(3)(B) consistent with Joint TDUs recommendation. The commission also agrees with ARM and Reliant that the rule should be clear that the regulatory asset must be adjusted for bad debt charges that are already being recovered through the TDU's rate, and has modified subsection (f)(3)(B) accordingly. Finally, the commission notes that cost recovery of a regulatory asset related to bad debt will be subject to review in a rate case pursuant to PURA §36.051.

Subsection (f)(4) Financial Documentation

Tara argued that the requirements under subsection (f)(4) are unreasonable and overly burdensome and suggested that the commission could reduce the burden by requesting financial information on an as-needed basis.

The requirement to provide audited financial statements on an annual basis was supported by Texas ROSE/TLSC. TXU did not oppose the requirement, and asked the commission to clarify the language in the rule to allow for the required annual audited financial statements to be those of the entity on which the REP relies for meeting the financial requirements. Similarly, ARM argued that a REP should be permitted to use the annual audited financial statements of its parent company. RCM argued that the requirement to provide audited financial statements annually establishes a dramatically higher standard, and proposed that privately held REPs be required to submit sworn statements quarterly, attesting to any aspect of their financial health the commission deems necessary. TEAM argued that the requirements for financial statements will impose significant costs on small REPs, and that the timing and frequency is not feasible. TEAM suggested that REPs be required to file only their most recent audited financial statements.

TXU recommended that REPs be allowed 120 days after the end of the year to provide the required annual audited financial statements. TXU recommended that the quarterly unaudited financial statements be provided no later than 60 days after the end of the quarter.

ARM argued that quarterly unaudited financial statements are unnecessary, expensive, and administratively burdensome, and recommended that the commission eliminate the requirement or make it discretionary. TXU disagreed with ARM and argued that the information is the key to understanding the health of a business. TXU, Reliant, and TEAM recommended that the requirements for quarterly unaudited financial statements be expanded to allow an officer's

certificate affirming that the quarterly unaudited financial statements have been prepared in accordance with generally accepted accounting principles.

Joint TDUs responded to the arguments from several REPs that the reporting requirements are costly and burdensome to small REPS, arguing that it is impossible for the commission to monitor compliance without financial reports. Joint TDUs noted that if the REP wants the imprimatur of commission approval and the benefit of being listed on the Power to Choose website, then the REP should do what is necessary to make information available to the commission.

ARM suggested that subsection (f)(4)(F) should be revised to clarify that a guaranty agreement or corporate commitment must be issued by a guarantor that meets *one* of the requirements in subsection (f)(1)(A), noting that the proposed rule states that the guarantor must satisfy *all* of the requirements of subsection (f)(1) and that an entity that can satisfy one of the standards under subsection (f)(1)(A) is in a better position to provide a guaranty. Reliant recommended deleting subsection (f)(4)(F) because subsection (f)(1), read in conjunction with subsection (b)(4), renders the language in subsection (f)(4)(F) unnecessary.

Commission Response

The commission finds that substantial confusion exists in the comments regarding the purpose of subsection (f)(4), and modifies rule language to clarify that subsection (f)(4) identifies and describes the financial documentation that is required to obtain REP certification. Additionally, some of the financial documentation required by subsection

(f)(4) may be required semi-annually pursuant to subsection (i) to maintain REP certification. Comments regarding the timing and frequency of reports are relevant to subsection (i) and not relevant to subsection (f)(4).

The commission disagrees with Tara that the requirements under subsection (f)(4) are overly burdensome, and that the commission could reduce the burden by requesting financial information on an as-needed basis. The requirements under subsection (f)(4) identify the financial documentation that is required to obtain certification and cannot be provided on an as-needed basis. To the extent that the financial documentation must be provided on a going-forward basis in subsection (i), the commission finds that the information should be provided semi-annually. A semi-annual reporting requirement appropriately balances the need for timely information with the burden that reporting places on REPs.

The commission agrees, in part, with ARM that a REP should be permitted to use the annual audited financial statements of its parent company. The commission finds that a REP may satisfy the requirement to provide financial statements by providing the financial statements of the REP or its guarantor, because the REP or guarantor, not necessarily the parent company, is required to demonstrate financial qualification. Additionally, subsection (f)(5)(C) allows the REP to provide financial statements for the consolidated company if the REP is part of a structure that is consolidated for financial reporting purposes and files financial reports with a federal agency on a consolidated company basis.

The commission disagrees with RCM that the requirement to provide audited financial statements establishes a dramatically higher standard and agrees with TXU that the information is the key to understanding the health of a business. The commission finds that, for REPs that do not have an investment-grade credit rating, audited financial statements are necessary to provide the commission with independent verification of tangible net worth pursuant to subsection (f)(1)(A)(ii) or shareholders' equity pursuant to subsection (f)(1)(B), and to provide both the REP and the commission with a complete accounting of the REP's financial health.

The commission disagrees with ARM that quarterly unaudited financial statements are unnecessary, expensive, and administratively burdensome. The commission finds that unaudited financial statements are necessary to provide timely information to support audited financial statements, which require more time and effort to prepare.

The commission agrees with TXU, Reliant, and TEAM that the requirements for unaudited financial statements should be expanded to allow an executive officer's certificate affirming that the unaudited financial statements have been prepared in accordance with generally accepted accounting principles. The commission modifies rule language in subsections (f)(4)(B) and (f)(4)(C) to allow a sworn statement from an executive officer attesting to the accuracy of unaudited financial statements, because requiring a review report from an accountant could significantly increase the burden and cost of compliance.

The commission agrees, in part, with ARM that subsection (f)(4)(F) should be revised to clarify that a guaranty agreement or corporate commitment must be issued by a guarantor that meets *one* of the requirements in subsection (f)(1)(A), noting that the proposed rule states that the guarantor must satisfy *all* of the requirements of subsection (f)(1). The commission notes that the provisions related to guarantors in the proposal for adoption are in subsection (f)(4)(G). The commission provides rule language in subsection (f)(4)(G) that allows a REP to meet the requirements of subsection (f)(1)(A) by relying upon a guarantor that meets one of the financial requirements of subsection (f)(1)(A). This subsection also lists the types of guarantors and agreements between the REP and the guarantor that are acceptable, so the commission disagrees with Reliant's suggestion that this subsection is superfluous.

Subsection (g)

ARM stated that the prefatory language of proposed subsection (g) should be amended to recognize that REPs may rely on their affiliates to meet the technical and managerial requirements for certification. TXU agreed. TEAM stated that it generally supported the enhanced requirements for management expertise contained in the proposed rule but suggested that the rule should state that the requisite experience can be provided through employees of parents, affiliates, or third-party contractors. RCM agreed.

REPower agreed that this section should allow the use of third-party vendors except where the use of such vendors is specifically precluded or otherwise addressed, such as in subsections

(g)(1)(E) and (g)(1)(F). Shell also requested that a REP be able to rely on third party vendors to demonstrate its technical and managerial resources, and those REPs should be able to continue to provide retail electric service through vendors.

Commission response

The commission agrees that the use of third party vendors is appropriate in some cases and allows REPs to use third party vendors to satisfy many requirements. However, the use of third party vendors for meeting technical and managerial requirements is not acceptable to the commission. The commission believes that the individuals relied on to meet these requirements should be fully integrated into the REP's business and has modified the definition of "permanent employee" accordingly.

Subsection (g)(1)(C)

ARM stated that proposed subsection (g)(1)(C) should be deleted because it is inconsistent with the structure and organization of the proposed rule, as it is a financial and not a technical or managerial requirement. ARM also suggested deletion of the proposed subsection because the capital access requirement of proposed subsections (f)(1)(A) and (B) should cover this and other normal, day-to-day REP payment obligations.

Commission response

The commission agrees with ARM that the capital requirements of subsections (f)(1)(A) and (f)(1)(B) address a REP's financial ability to purchase ancillary services and deletes this requirement from subsection (g)(1)(C).

Subsection (g)(1)(E), now (g)(1)(D)

TXU agreed with the spirit and direction of the changes in the proposed rule but questioned whether the requirement of proposed subsection (g)(1)(E) would achieve the commission's goals. TXU stated that the requirement could be satisfied by eight employees with two years of experience each and that it is not clear that any number of employees with only two years of experience should be sufficient to satisfy the technical and managerial requirements. TXU suggested requiring that at least one principal or permanent employee have at least five years of relevant experience. NEM stated that its members participate in virtually every other jurisdiction open to competition and NEM is not aware of any other jurisdiction that imposes a 15 year technical requirement.

En-Touch commented that the proposed rule does not place any value on the experience of telecommunications experts who have experience in a broad range of skills to provide excellent service to customers such as call center operations, sales, marketing, customer service, contract negotiation, wholesale service agreements, plant engineering and operations, project management and other operational support systems, finance and business planning. En-Touch

supports subsection (g)(1)(E) but requests that subsection (g)(1)(E) allow experience in the telecommunications industry.

TXU disagreed with En-Touch and stated that the risks inherent to the retail electric business are unique and the only relevant experience for satisfaction of the commission's rule should be experience in the electric industry.

Commission response

Adopted subsection (g)(1)(D) requires a REP to have executive officers, principals, or permanent employees in managerial positions with combined experience in the competitive electric industry or competitive gas industry that equals or exceeds 15 years. However, even if a REP applicant meets the literal requirement of this provision, the commission still retains the discretion to determine whether the applicant would satisfy the overarching requirement of subsection (g): “A REP must have the technical and managerial resources and ability to provide continuous and reliable retail electric service to customers, in accordance with its customer contracts, PURA, commission rules, ERCOT protocols, and other applicable laws.” Therefore, even though a REP may meet the literal requirement of adopted subsection (g)(1)(D), the commission will review the experience of the applicant's personnel on a case-by-case basis to determine whether the applicant would satisfy subsection (g)'s overarching requirement.

The commission agrees with TXU that the many of the risks in the retail electric industry result from a volatile commodity and are unique to retail electricity and, some extent, natural gas. The commission does not accept the changes proposed by En-Touch.

Subsection (g)(1)(F), now (g)(1)(E)

Joint TDUs stated that the requirement of proposed subsection (g)(1)(F) is appropriate given the commodity risk managed by a REP but suggested that the definition of substantial energy portfolio be increased to \$1 million. Joint TDUs noted that an energy portfolio of \$100,000 is not a substantial energy portfolio, and the commodity risk of a REP will likely far exceed that amount. TXU agreed with Joint TDUs suggestion.

ARM stated that proposed subsection (g)(1)(F) should be amended (1) to require that the contract be negotiated at arm's length to ensure its legitimacy, (2) to increase the minimum value of the substantial energy portfolio to \$10,000,000 to ensure some level of expertise in the context of commercial customers or a large residential portfolio, and (3) to require that a third-party provider of commodity risk management services must demonstrate that its technical and managerial expertise meets the requirements of the section.

OPC stated that the definition of substantial energy portfolio should be increased to \$3 million.

NEM suggested that competence is not necessarily proven by years of experience and the commission should allow for a more subjective standard other than years of experience. RCM

agreed and proposed that, in addition to one employee having five years of commodity risk management experience, REPs should be required to have at least one employee who has completed the currently available ERCOT sponsored training covering the areas of retail operations, wholesale market operations, and any other ERCOT-sponsored training that the PUC deemed necessary. RCM also proposed that if a test is made available by ERCOT for any of the trainings, then one employee must pass the test. RCM also felt that knowledge of customer protection rules and PUC rules should be demonstrated, and that applicants should be able to pass a written test if administered.

Commission Response

The commission agrees with ARM that the minimum value of the “substantial energy portfolio” should be increased to \$10,000,000.

The commission determines that the most objective approach is to require a specified number of years of experience. While the commission recognizes that some people with years of experience may not have the knowledge to operate a REP, and some may be capable with less experience than the requirement, the commission requires a simple objective approach to evaluating the technical and managerial requirements and believes that it has chosen the best approach. For these reasons, the commission disagrees with the suggestions of NEM and RCM.

Subsection (g)(1)(G)

OPC stated that the proposed rule should clarify that technical and managerial requirements include equipment, software, staffing and employee training and other necessary resources. OPC also stated that subsection (g)(1)(G) should be amended to apply directly to the company's provision of a customer service center that is not covered in other sections of the rule. Specifically, OPC stated that the section be amended to refer to the provision of customer service at fully staffed levels at least five days a week from 8 a.m. to 9 p.m.

Commission response

The commission determines that §25.485 of this title (relating to Customer Access and Complaint Handling) addresses customer access to customer service centers and, therefore, does not make the changes sought by OPC for this section.

Subsection (g)(1)(I), now (g)(1)(H)

OPC stated that subsection (g)(1)(I) should be amended to require a REP to describe the actions that the REP has undertaken and the steps that the REP will complete to ensure compliance with the commission's customer protection and anti-discrimination rules.

Commission response

The commission concludes that OPC's concern is adequately addressed by subsection (g)(1)(H)'s requirement that a REP applicant have a customer service plan that describes how the applicant will comply with the commission's customer protection rules.

*Subsection (g)(2)(B)**Commission Response*

The commission revises subsection (g)(2)(B) to clarify the required information and to allow a REP to request a limitation on the information that must be provided when strict compliance with the provision would be unduly burdensome. For example, it may be unduly burdensome and unnecessary for a company that is controlled by a large, multinational holding company with dozens, if not hundreds, of subsidiaries world-wide to comply strictly with the provision.

Subsection (i)

TIEC commented that subsection (i) of the proposed rule contains ambiguities regarding Option 2 REPs. Under subsection (d)(2)(B), the only provisions of the proposed rule that would apply to Option 2 REPs are subsections (e), (f)(5), and (i). However, it appeared to TIEC that parts of the rule that do not apply to Option 2 REPs under subsection (d)(2)(B) may nonetheless be applied through subsection (i). Specifically, TIEC recommended that subsection (i) should be revised so that it does not inadvertently subject Option 2 REPs to certain financial requirements

from which Option 2 REPs should be exempted. The subsections containing these financial requirements are not included in subsection (d)(B)(2), which specifically lists the provisions of the rule that apply to Option 2 REPs. However, subsection (i), which does apply to Option 2 REPs, appeared to incorporate some of these inapplicable provisions by reference.

NRG stated that Option 2 REPS are not required to file financial information as provided for in the proposed rule and PURA in order to be certified. NRG stated that PURA allows REPs serving customers with one MW or more to be certified by filing an affidavit and without demonstrating financial or technical capability. NRG emphasized that those customers are capable of ensuring that their REPs can handle their commercial and operational risks and added that the provision of additional financial information to the commission would be an unnecessary burden for Option 2 REPs and should be limited to Option 1 REPs. NRG opined that because Option 2 REPs serve a limited number of customers with tailored agreements, subsection (i)(7) is unduly restrictive to commercial options that may be negotiated between Option 2 REPs and their customers, and limits how such agreements may be structured.

NRG suggested that subsection (i)(10) should be limited to Option 1 REPs because large customers do not require unnecessary customer protection. NRG added that the provision is not specific as to the kind of information that might be requested of a REP; therefore, the commission might request extensive information of Option 2 REPs beyond what is required for certification. NRG further emphasized that Option 2 REPs are less likely to be prepared to provide extensive data on a short notice because Option 2 REPs have limited operations. If the

provision is kept, then NRG suggested that it only be limited to information directly supporting or updating the information required in the application for certification.

TIEC agreed with NRG that PURA does not require Option 2 REPs to demonstrate specific financial or technical requirements to the commission in order to be certified. TIEC agreed with NRG that imposing specific financial requirements on Option 2 REPs would be inconsistent with PURA and would undermine the commercial flexibility that is a primary motivation for becoming an Option 2 REP. TIEC stated that none of the other parties filing comments contended that it was appropriate to apply specific requirements to Option 2 REPs and therefore Option 2 REPs should be exempted from subsections (i)(4), (i)(5)(C), and (i)(6). TIEC requested that the rule be revised to make it clear that Option 2 REPs must only file an audited financial statement for the most recent completed calendar or fiscal year. TIEC maintained that conducting quarterly audits would be problematic, costly, and time consuming and insisted that Option 2 REPs should be able to guaranty the accuracy of the quarterly reports through an affidavit.

TIEC agreed with NRG that the reporting deadlines imposed in subsections (i)(7) and (10) are restrictive and unnecessary for the customers served by Option 2 REPs who are able to protect themselves through tailored contracts. TIEC maintained that these restrictive deadlines would impair the ability of Option 2 REPs to design contract terms to best meet the needs of its customers and, for that reason, Option 2 REPs should be excluded from subsections (i)(7) and (10) of the proposed rule.

TIEC sought clarification that an Option 2 REP that serves its parent company may continue to submit a consolidated financial report with that parent, which would more accurately reflect the REP's financial condition. TIEC cautioned that the April 1 deadline for the annual financial reports could be difficult to meet for some Option 2 REPs.

TXU stated that the current rule and proposed rule are confusing with regard to when a REP must apply to amend a certificate and when it is only required to provide notice to the commission. TXU pointed out that the proposed rule would require a REP to amend a certificate within 10 days of a "material change to the information provided to the commission as the basis for the commission's approval of the certification application." TXU stated that it is not always clear whether a change "is material" or whether the change is to information that provided the "basis for the commission approval" and quoted the commission's Amendment Application for REPs (Instructions) which states that "commission rules require notice of some changes that do not require 'approval'." TXU asked that the commission clarify changes that require an application to amend a certificate. TXU urged the commission to revise proposed subsections (i)(5)(C) and (i)(6) in line with TXU's suggestions regarding subsections (f)(4)(A) and (f)(4)(B) to clarify the language to allow for the required financial statements to be those of the entity on which the REP relies for meeting the financial requirements, and not necessarily of the REP itself. In the event that the commission leaves the requirement as proposed, TXU asked for the same grace period in this subsection as requested with regard to subsections (f)(4)(A) and (B).

NEM argued that the requirement to provide a 45-day notice to the commission and other interested parties before the REP ceases to operate is inadequate because events like the recent

convergence in market conditions could result in a sudden default of a REP, making it impossible to provide consumers or the commission with long notice periods. NEM stated that the 45-day notice period may not effectively address the issues raised by the REP defaults, thus further supporting an argument in favor of a solution implemented through the POLR rules.

Cities suggested that the proposed rule should establish a requirement, by commission order, for a short deadline (*e.g.*, 30 days or less) for a REP which is no longer in compliance with subsection (f)(1)(A) to come into compliance with subsection (f)(1)(B) upon notification provided for in subsection (i)(4).

First Choice suggested that the proposed annual report filing date should be changed from April 1 to June 30 of each year because the April 1 date does not provide sufficient time to prepare audited financial statements and include the audited balance sheet in the annual report.

ARM agreed with a June 1 deadline in the current rule, provided that the filing of the audited financial statements may lag and will need to be filed separately on a later date. However, as an alternative, ARM recommended that the deadline move to July 1 to allow more time for preparing additional financial documentation.

Reliant requested deletion of subsection (i)(4), and argued that the provision is unnecessary because of subsection (i)(3)'s requirement that a REP apply to amend its certification within ten days of a material change. OPC disagreed and argued that the inability to meet the basic financial standards of subsection (f)(1) warrants immediate commission notification. Reliant,

ARM, and OPC recommended that the reference to “violation” of subsection (f)(1)(A) or (B) be changed to “noncompliance.” ARM stated that non-compliance with the financial requirements in the proposed rule can result in a critical situation (*e.g.*, the investment-grade credit rating upon which the REP has relied is downgraded below investment grade) that requires the REP to re-achieve compliance as quickly as possible. ARM also stated that the rule should require the REP to submit a remedial plan to achieve compliance with proposed subsection (f)(1)(A) or (f)(1)(B) within a specified period of time.

ARM agreed, in part, with OPC and advocated the use of the term “state of non-compliance” instead of “violation” stating that only the commission can determine whether a violation of its certification rule has taken place. ARM proposed five days, instead of three days, for the resolution of the non-compliance issue, stating that the proposed deadline may not always be realistic if the REP does not find its state of compliance immediately. ARM stated that the rule should require the REP to submit a remedial plan, within three days after the date the commission is notified, that will achieve compliance with subsections (f)(1)(A) or (f)(1)(B) within 15 days.

Joint TDUs stated that the current certification rule applicable to large REPs requires that information provided to the commission regarding the REP’s financial condition also be made available to the TDU. Joint TDUs stated that disclosure to the TDU of the REP’s financial condition is needed to monitor compliance with applicable TDU deposit requirements. Joint TDUs emphasized that it is particularly important for TDUs to be informed of conditions that would drop the REP from qualification under subsection (f)(1)(A) into subsection (f)(1)(B), at

which point the deposit requirements would apply. Joint TDUs suggested that TDUs should also receive information on transfers of certificates, transfers of control, or other changes reported to the commission. Joint TDUs proposed that subsection (i)(9) retain the obligation to make this information available to the TDU and expand the obligation to all REPs. Reliant urged the commission to reject Joint TDUs proposal. Reliant maintained that such information is available at public filings for publicly traded companies and private companies should not be obligated to provide this information to the TDUs, as only the commission, can make the decision whether the REP has the financial ability to be a REP.

Joint TDUs disagreed with the argument from many REPs that the reporting requirements contained in the proposed rule are burdensome. Joint TDUs argued that the commission cannot monitor compliance with its rules without financial reports from the REPs, and that REPs should provide all necessary information to the commission in order to be approved and listed on the Power to Choose website as an alternative to be considered by consumers.

OPC proposed a requirement that subsection (i)(4) provide for penalties and/or sanctions or termination of certification in the event of failure to file notice with the commission.

OPC disagreed with Reliant and opposed the deletion of subsection (i)(4) as proposed by Reliant under the supposition that if a REP does not meet the requirements of either subsection (f)(1)(A) or (f)(1)(B), then the REP will notify the commission under the material change provision of subsection (i)(3). OPC emphasized that the inability to meet the basic financial standards of subsection (f)(1) is a serious condition that requires immediate commission notification.

Tara stated that subsections (i)(5)(C) and (i)(6) introduce high costs for REPs that will be required to submit not only annual audits, but also unaudited quarterly financials, imposing disproportionately high costs on smaller REPs that are not publicly traded and not required to conduct annual audits or produce quarterly reports. Tara opined that the commission already has the ability to obtain the information needed without imposing new time-consuming and costly requirements on a quarterly basis. Tara argued that the requirement in subsection (i)(10) for REPs to respond within three days to any commission request for additional information to prove continued compliance with this section is untenable, and argued that REPs should be allowed to respond to formal requests for such information in a three to four weeks time frame. Tara cautioned that the proposed rule would not provide enough time for the REP to verify accuracy of the information, and noted that provision of false information is punishable under the Texas Penal Code.

ARM stated that the proposed subsection be modified to make it clear that the material change the commission is authorized to review is a change in the information relied upon by the commission when it granted the REP's initial application for certification, or any subsequent certificate amendment. ARM stated that the appropriate base for determining whether a material change has occurred is the REP's current certificate, rather than the certification application originally filed. ARM pointed out that the transfer of a certificate or a change in the control or ownership of a REP may not always involve a material change in such information.

ARM stated that the expansion of filing requirements in subsection (i)(5)(C) should also include the filing of such documentation demonstrating initial compliance with the applicable requirements of subsections (f)(1)-(3). Alternatively, ARM thought that an earlier filing date to demonstrate initial compliance with the new certification rule may be appropriate, depending on the effective date of the new rule and the deadline by which REPs must achieve compliance with the new rule. ARM also recommended that subsection (i)(5) be clarified to allow a REP to file its parent company's audited annual financial statements to meet both the standard filing requirement for annual financial statements and the requirement to file all documentation demonstrating continuing compliance with the financial requirements in subsection (f)(1)-(3), as required by subsection (f)(4). ARM contended that this subsection must indicate that a REP may designate information filed in and as part of the annual report as confidential and proprietary, in line with the requirements for such information in subsection (c)(3).

ARM proposed that subsection (i)(5) be deleted, arguing that many REPs do not prepare a complete set of quarterly unaudited financial statements because the statements are expensive and administratively burdensome. ARM stated that, as an alternative, the proposed subsection could permit the filing of quarterly unaudited financial statements and accompanying documentation, if available, rather than make it mandatory. ARM proposed that subsection (i)(7) should be modified to account for a suspension or withdrawal of the certificate at the REP's discretion.

Commission Response

The commission finds that it must balance the need for information regarding the financial condition of REPs with the cost to provide such information, which is ultimately paid by consumers. The commission is concerned about the burden to provide financial information, as well as the impact on commission resources of collecting and reviewing financial information. To address these concerns, the commission establishes a semi-annual reporting requirement and eliminates the requirement to provide financial reports on a quarterly basis. The semi-annual report requires a demonstration that the REP continues to satisfy the financial requirements of subsections (f)(1) and (2). The commission maintains the requirement to provide audited financial statements annually, as an independent standard to periodically verify affirmations and unaudited information.

The commission agrees with TIEC that subsection (i) should be revised. The commission modifies rule language in subsection (i) so that REPs that obtained certification pursuant to subsection (d)(2) are not subjected to requirements that do not apply to Option 2 REPs. Pursuant to PURA §39.352(d), the commission finds that Option 2 REPs are not subject to the requirements of adopted subsection (i)(4) and (5).

The commission disagrees with TXU that the rule is confusing regarding when notice or an amendment is required. Subsection (i) clearly identifies each action that requires notice and each action that requires certification amendment.

The commission agrees with OPC that Reliant’s proposed deletion of subsection (i)(4) should be rejected. Because of the importance of meeting the requirements of subsection (f)(1), the commission is requiring a REP in violation of subsection (f)(1) to notify it within three working days of violation of this provision. The commission also agrees with ARM that such a violation should be corrected as quickly as possible and that the REP should be required to submit a remedial plan to achieve compliance with subsection (f)(1)(A) or (f)(1)(B) within a specified period of time. The commission does not object to using the term “non-compliance” rather than “violation,” in order to acknowledge that a REP may be in violation of subsection (f)(1) for reasons beyond its reasonable control. The commission has made changes to subsection (i)(4) accordingly.

The commission agrees with Cities that the rule should provide a deadline for REPs that are no longer in compliance with subsection (f)(1) to come into compliance with (f)(1), and the commission has changed the rule accordingly.

The commission disagrees with Joint TDUs that REPs should provide information regarding their financial condition to the TDUs. The commission finds that TDUs do not need this information to protect their financial integrity because TDUs are allowed create a regulatory asset to recover REP bad debts, and the provision that allows a TDU to collect deposits from all REPs is deleted.

The commission disagrees with OPC's suggestion that subsection (i)(4) should provide for penalties or sanctions for failure to provide the required notice, because subsection (j)(17) and §22.246 of this title (relating to Administrative Penalties) adequately address this issue.

Subsection (j)

TXU stated that the 16 significant violation categories include felony convictions, a pattern of failing to comply with the law, and bankruptcy on one end of the spectrum, and a single inadvertent switch or billing error on the other end of the spectrum. TXU noted that the Legislature amended PURA in 2005 to direct the commission to develop a classification system for violations. TXU recommended that the commission revise subsection (j) to make it consistent with PURA §15.023 and P.U.C. Substantive Rule §25.8.

Commission Response

The commission disagrees with TXU's comment. This subsection does not set forth a classification system because the commission believes that the general classification system in §25.8 of this title appropriately classifies violations of this section.

Comments Regarding the Small Business Analysis Section of the Preamble

TEAM stated that the economic impact statement and regulatory flexibility analysis contained in the preamble provide only conclusions and are not factually grounded. Regarding the impact of the proposed rule on small businesses, TEAM stated that far more than 30 REPs have fewer than

100 employees. TEAM stated that it believes that the vast majority of Option 1 REPs are small businesses that could be adversely affected by the proposed rule. TEAM also stated that the preamble seems only to address the liquid capital requirements and does not address the increased cash requirement of the TDU deposit. TEAM stated that the deposit as proposed would be one-sixth of the annual billings by all TDUs and would have a significant detrimental impact on REPs that are small businesses. TEAM disagreed with the statement in the preamble that the proposed rule can be considered to have no economic costs to, and no adverse effect on, REPs because the proposal sets forth the minimum requirements to operate a REP prudently. TEAM noted that numerous REPs operate in a prudent manner, providing a wide array of competitive options under the current rule. TEAM also noted that the statement is inconsistent with statements made elsewhere in the proposal for publication that some REPs will go out of business as a result of the increased requirements of the rule. TEAM stated that there is nothing that justifies provisions of the proposed rule that add significant burdens to REPs that are small businesses. TEAM stated that the requirements could drive REPs out of business or keep new REPs from coming into the market and would increase the cost to provide service to customers. TEAM stated that the provisions of the proposed rule related to modification of the financial requirements and the requirement for TDU deposits do not meet the requirements of Senate Bill 700 and Texas Government Code Chapter 2006.

In its reply, TEAM stated that the commission should carefully review the disparate impacts that the proposed rule could have on small businesses. TEAM stated that increasing the cost of participation in the market for small businesses while decreasing the cost for publicly traded investment-grade companies is anticompetitive and does not appear to comply with the statutory

regulatory flexibility analysis of Texas Government Code §2006.002. TEAM stated that a REP acting as a small business in Texas could be considered to include a REP who serves 1% of the residential and commercial market (excluding large commercial), which equates to 52,000 residential customers and 9,300 small and medium commercial customers. TEAM stated that under the proposed rule, such a REP would be required to post approximately \$7.46 million in TDU deposits and that the proposed rule provides no analysis of this impact. TEAM stated that the proposed rule does not address the cost impact to the remainder of the market associated with REPs exiting the market as a result of the proposed rule. TEAM stated that the commission's draft scope of competition report indicates that 43 REPs serve 500 or more residential customers. TEAM also stated that those REPs are presumably of particular concern to the commission in adopting the proposed rule and that the rule should provide a regulatory impact and regulatory flexibility analysis for those REPs that are small businesses.

REPower agreed with TEAM's statement that the vast majority of Option 1 REPs in the retail electric market are small businesses that could be adversely affected by the proposed rule. REPower also agreed with TEAM that the provisions of the proposed rule related to modification of the financial requirements and the requirement for TDU deposits do not meet the requirements of Senate Bill 700 and Texas Government Code §2006.002. REPower supported TEAM's argument that the proposed rule does not allow sufficient time for an existing REP to make arrangements to meet the financial requirements. REPower also agreed that there is restricted access to capital in the current financial environment. REPower stated that the commission should allow a longer timeline for REPs to demonstrate compliance with any new financial requirements.

Commission Response

The commission disagrees with TEAM and REPower that the provisions of the proposed rule do not meet the requirements of Senate Bill 700 and Texas Government Code §2006. The commission finds that the economic impact statement and regulatory flexibility analysis were prepared in a manner consistent with Texas Government Code §2006.002 and the Final Guidelines adopted by the Office of the Attorney General (“Guidelines”) pursuant to §2006.002(g). The commission’s economic impact statement and regulatory flexibility analysis represent a reasonable, good-faith effort that provides the public and affected small businesses with information about the potential adverse effects of the proposed rule and about potentially less-burdensome alternatives, and such interested persons were provided with an opportunity to comment on the economic impact statement and the regulatory flexibility analysis.

The commission disagrees with TEAM that the economic impact statement and regulatory flexibility analysis contained in the preamble provide only conclusions that are not factually grounded. The commission finds that each of the conclusions contained in the economic impact statement and the regulatory flexibility analysis are based on facts and data available to the commission at the time the proposed rule was published.

The commission agrees with TEAM that more than 30 REPs have fewer than 100 employees, and disagrees with TEAM and REPower that the vast majority of Option 1 REPs are small businesses. The commission finds that there are over 100 REPs that have

fewer than 100 employees. The commission believes that many of the business functions of a REP are outsourced, which reduces the number of employees to below 100 for REPs that might be considered large by other measures. Texas Government Code §2006.002 defines a small business as “an entity that is for profit, independently owned and operated, and has fewer than 100 employees or less than \$6 million in annual gross receipts.” The Guidelines provide that independently owned and operated businesses are self-controlling entities that are not subsidiaries of other entities or otherwise subject to control by other entities and entities that are publicly traded. Each of the three standards must be met in order for an entity to qualify as a small business. To qualify as a small business, a REP must (1) be a for profit business, be independently owned and operated, and have fewer than 100 employees, or (2) be a for profit business, be independently owned and operated, and have less than \$6 million in annual gross receipts. The commission has sufficient data to conclude that approximately 30 REPs are small businesses.

The commission agrees with TEAM and REPower that the deposit requirement to protect TDU financial integrity in subsection (f)(3) of the proposed rule would have a significant impact on REPs that are small businesses. The provision is deleted.

The commission disagrees with TEAM’s statement that increasing the cost of participation in the market for small businesses while decreasing the cost for publicly traded investment-grade companies is anticompetitive and does not appear to comply with the statutory regulatory flexibility analysis of Texas Government Code §2006.002. The commission finds that the rule does not set the cost of participation in the market. The cost of participation

in the market is a function of market conditions and creditworthiness. The financial requirements in the rule require a demonstration that the REP has access to the capital that the commission believes successful market participation will require.

The commission modifies the proposed rule language to mitigate the impact on small businesses, consistent with the regulatory flexibility analysis required by Texas Government Code §2006.002. The commission reduces the amount of capital required to demonstrate and maintain financial qualification for REP certification, exempts REPs that began serving load on or before January 1, 2009 from the requirement to demonstrate shareholders' equity in subsection (f)(1)(B), expands the types of accounts that can be used to secure customer deposits and advance payments under subsection (f)(2)(B), allows a monthly reconciliation of customer deposit accounts, eliminates the requirement to provide deposits to protect TDU financial integrity, broadens the ability of REPs that are small businesses to qualify under subsection (f)(1)(A) and avoid the requirements of subsection (f)(1)(B) and (f)(2)(B) by expanding the types of guarantors and agreements under subsection (f)(4)(G), eliminates the requirement to provide unaudited financial statements on a quarterly basis and establishes a semi-annual reporting requirement, allows affirmation of unaudited financial statements by an executive officer instead of requiring a review by a certified public accountant, expands the amount of time that a REP has to come into compliance from six months to 12 months, and expands the scope of the 12-month phase-in to include all of §25.107.

The repeal and new rule are adopted under PURA, Texas Utilities Code Annotated §14.002 (Vernon 2007 and Supp. 2008), which requires the commission to adopt rules reasonably required in the exercise of its powers and jurisdiction; and specifically, PURA §39.352, which requires the commission to certify a person as a REP if the person demonstrates, among other things, the financial and technical resources to provide continuous and reliable electric service, the managerial and technical ability to supply electricity at retail in accordance with customer contracts, and the resources needed to meet customer protection requirements and which requires a person applying for certification as a REP to comply with all customer protection provisions, disclosure requirements, and marketing guidelines established by the commission and PURA; PURA §17.004, which authorizes the commission to adopt and enforce rules concerning REPs that protect customers against fraudulent, unfair, misleading, deceptive, or anticompetitive practices and that impose minimum service standards relating to customer deposits and termination of service; PURA §§17.051-17.053, which authorize the commission to adopt rules for REPs concerning certification, changes in ownership and control, customer service and protection, and reports; and PURA §39.101, which authorizes the commission to adopt and enforce rules that ensure retail customer protections that entitle a customer: to safe, reliable, and reasonably priced electricity, to other information or protections necessary to ensure high-quality service to customers including protections relating to customer deposits and quality of service, and to be protected from unfair, misleading, or deceptive practices, and which requires the commission to ensure that its customer protection rules provide at least the same level of customer protection against potential abuses and the same quality of service that existed on December 31, 1999.

Cross Reference to Statutes: PURA §§14.002, 17.004, 17.051-17.053, 39.101, and 39.352.

§25.107. Certification of Retail Electric Providers (REPs).

- (a) **Applicability.** This section applies to all persons who provide or seek to provide electric service to retail customers in an area in which customer choice is in effect and to retail customers participating in a customer choice pilot project authorized by the commission. This section does not apply to the state, political subdivisions of the state, electric cooperatives or municipal corporations, or to electric utilities providing service in an area where customer choice is not in effect. An electric cooperative or municipally owned utility participating in customer choice may offer electric energy and related services at unregulated prices directly to retail customers who have customer choice without obtaining certification as a REP.
- (1) A person must obtain a certificate pursuant to this subsection before purchasing, taking title to, or reselling electricity in order to provide retail electric service.
 - (2) A person who does not purchase, take title to, or resell electricity in order to provide electric service to a retail customer is not a REP and may perform a service for a REP without obtaining a certificate pursuant to this section.
 - (3) A REP that outsources retail electric functions remains responsible under commission rules for those functions and remains accountable to applicable laws and commission rules for all activities conducted on its behalf by any subcontractor, agent, or any other entity.
 - (4) All filings made with the commission pursuant to this section, including a filing subject to a claim of confidentiality, shall be filed with the commission's Filing Clerk in accordance with the commission's Procedural Rules, Chapter 22, Subchapter E, of this title (relating to Pleadings and other Documents).

- (b) **Definitions.** The following words and terms when used in this section shall have the following meaning unless the context indicates otherwise:
- (1) **Affiliate** – An affiliate of, or a person affiliated with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under the common control with, the person specified.
 - (2) **Continuous and reliable electric service** – Retail electric service provided by a REP that is consistent with the customer's terms and conditions of service and uninterrupted by unlawful or unjustified action or inaction of the REP.
 - (3) **Control** – The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise.
 - (4) **Customer** – Any entity who has applied for, has been accepted for, or is receiving retail electric service from a REP on an end-use basis.
 - (5) **Default** – As defined in a transmission and distribution utility (TDU) tariff for retail delivery service, Electric Reliability Council of Texas (ERCOT) qualified scheduling entity (QSE) agreement, or ERCOT load serving entity (LSE) agreement.
 - (6) **Executive officer** – When used with reference to a person means its president or chief executive officer, a vice president serving as its chief financial officer, or a vice president serving as its chief accounting officer, or any other officer of the person who performs any of the foregoing functions for the person.

- (7) Guarantor – A person providing a guaranty agreement, business financial commitment, or a credit support agreement providing financial support to a REP or applicant for REP certification pursuant to this section.
- (8) Investment-grade credit rating – A long-term unsecured credit rating of at least “Baa3” from Moody’s Investors’ Service, or “BBB-” from Standard & Poor’s or Fitch, or “BBB” from A.M. Best.
- (9) Permanent employee – An individual that is fully integrated into a REP’s business organization. A consultant is not a permanent employee.
- (10) Person – Includes an individual and any business entity, including and without limitation, a limited liability company, a partnership of two or more persons having a joint or common interest, a mutual or cooperative association, and a corporation, but does not include an electric cooperative or a municipal corporation.
- (11) Principal – A person or a member of a group of persons that controls the person in question.
- (12) Retail electric provider – A person that sells electric energy to retail customers in this state. As provided in Public Utility Regulatory Act (PURA) §39.353(b), a REP is not an aggregator.
- (13) Shareholder – The term shareholder means the legal or beneficial owner of any of the equity of any business entity, including without limitation and as the context and applicable business entity requires, stockholders of corporations, members of limited liability companies and partners of partnerships.

- (14) Tangible net worth – Total shareholders’ equity, determined in accordance with generally accepted accounting principles, less intangible assets other than goodwill.
- (15) Working day – A day on which the commission is open for the conduct of business.

(c) **Application for REP certification.**

- (1) A person applying for certification as a REP must demonstrate its capability of complying with this section. A person who operates as a REP or who receives a certificate under this section shall maintain compliance with this section.
- (2) An application for certification shall be made on a form approved by the commission, verified by oath or affirmation, and signed by an executive officer of the applicant.
- (3) Except where good cause exists to extend the time for review, the presiding officer shall issue an order finding whether an application is deficient or complete within 20 working days of filing. Deficient applications, including those without necessary supporting documentation, will be rejected without prejudice to the applicant’s right to reapply.
- (4) While an application for a certificate is pending, an applicant shall inform the commission of any material change in the information provided in the application within ten working days of any such change.

- (5) Except where good cause exists to extend the time for review, the commission shall enter an order approving, rejecting, or approving with modifications, an application within 90 days of the filing of the application.
- (d) **REP certification requirements.** A person seeking certification under this section may apply to provide services under paragraph (1) or (2) of this subsection, and shall designate its election in the application.
- (1) **Option 1.** This option is for a REP whose service offerings will be defined by geographic service area.
- (A) An applicant must designate one of the following categories as its geographic service area:
- (i) The geographic area of the entire state of Texas;
 - (ii) A specific geographic area (indicating the zip codes applicable to that area);
 - (iii) The service area of specific TDUs or specific municipal utilities or electric cooperatives in which competition is offered; or
 - (iv) The geographic area of ERCOT or other independent organization to the extent it is within Texas.
- (B) A REP with a geographic service area is subject to all subsections of this section, including those pertaining to basic, financial, technical and managerial, customer protection, and reporting and changing certification requirements.

- (C) The commission shall grant a certificate to an applicant proposing to provide retail electric service to a geographic service area in Texas if it demonstrates that it meets the requirements of this section.
 - (D) The commission shall deny an application if the configuration of the proposed geographic area would discriminate in the provision of electric service to any customer because of race, creed, color, national origin, ancestry, sex, marital status, lawful source of income, disability, or familial status; because the customer is located in an economically distressed geographic area or qualifies for low income affordability or energy efficiency services; or because of any other reason prohibited by law.
- (2) **Option 2.** This option is for a REP whose service offerings will be limited to specifically identified customers, each of whom contracts for one megawatt or more of capacity. The applicant shall be certified as a REP only for purposes of serving the specified customers. The commission shall grant a certificate under this paragraph if the applicant demonstrates that it meets the requirements of this paragraph.
- (A) A person seeking certification under this paragraph must file with the commission a signed, notarized affidavit from each customer, with whom it has contracted to provide one megawatt or more of capacity. The affidavit must state that the customer is satisfied that the REP meets the standards prescribed by PURA §39.352 (b)(1)-(3) and (c).

(B) The following subsections apply to REPs certified pursuant to this paragraph:

- (i) Subsection (e) of this section (relating to Basic Requirements);
- (ii) Subsection (f)(5) of this section (relating to Billing and Collection of Transition Charges); and
- (iii) Subsection (i) of this section (relating to Requirements for Reporting and Changing Certification).

(e) **Basic requirements.**

(1) **Names on certificates.** All retail electric service shall be provided under names set forth in the granted certificate. If the applicant is a corporation, the commission shall issue the certificate in the corporate name of the applicant.

(A) No more than five assumed names may be authorized for use by any one REP at one time.

(B) Business names shall not be deceptive, misleading, vague, otherwise contrary to §25.272 of this title (relating to Code of Conduct for Electric Utilities and Their Affiliates), or duplicative of a name previously approved for use by a REP certificate holder.

(C) If the commission determines that any requested name does not meet the requirements of subparagraph (B) of this paragraph, it shall notify the applicant that the requested name shall not be used by the REP. An application shall be dismissed if an applicant does not provide at least one suitable name.

(2) **Office requirements.** A REP shall continuously maintain an office located within Texas for the purpose of providing customer service, accepting service of process and making available in that office books and records sufficient to establish the REP's compliance with PURA and the commission's rules. The office satisfying this requirement for a REP shall have a physical address that is not a post office box and shall be a location where the above three functions can occur. To evaluate compliance with requirements in this paragraph, the commission staff may visit the office of a REP at any time during normal business hours. An applicant shall demonstrate that it has made arrangements for an office located in Texas.

(f) **Financial requirements.**

(1) **Access to capital.** A REP must meet the requirements of subparagraphs (A) or (B) of this paragraph.

(A) A REP or its guarantor electing to meet the requirements of this subparagraph must demonstrate and maintain:

- (i) an investment-grade credit rating; or
- (ii) tangible net worth greater than or equal to \$100 million, a minimum current ratio (current assets divided by current liabilities) of 1.0, and a debt to total capitalization ratio not greater than 0.60, where all calculations exclude unrealized gains and losses resulting from valuing to market the power contracts and financial instruments used as supply hedges to serve load, and such

calculations are supported by an affidavit from an executive officer of the REP attesting to the accuracy of the calculation.

- (B) A REP electing to meet the requirements of this subparagraph must demonstrate shareholders' equity, determined in accordance with generally accepted accounting principles, of not less than one million dollars for the purpose of obtaining certification, and the REP or its guarantor must provide and maintain an irrevocable stand-by letter of credit payable to the commission with a face value of \$500,000 for the purpose of maintaining certification.
- (i) The required shareholders' equity of one million dollars shall be determined net of assets used for collateral pledged to secure the irrevocable stand-by letter of credit of \$500,000.
- (ii) For the period beginning on the date of certification and ending two years after the REP begins serving load, a REP shall not make any distribution or other payment to any shareholders or affiliates if, after giving effect to the distribution or other payment, the REP's shareholders' equity is less than one million dollars, net of assets used for collateral pledged to secure the irrevocable stand-by letter of credit of \$500,000. The restriction on distributions or other payments contained in this subparagraph includes, but is not limited to, dividend distributions, redemptions and repurchases of equity securities, or loans to shareholders or affiliates.

(iii) A REP that began serving load on or before January 1, 2009 is not required to demonstrate the shareholders' equity required pursuant to subparagraph (B) of this paragraph, and is not subject to the restrictions on distributions or payments to shareholders or affiliates contained in subparagraph (B) of this paragraph.

(2) **Protection of customer deposits and advance payments.**

(A) A REP certified pursuant to paragraph (1)(A) of this subsection shall keep customer deposits and residential advance payments in an escrow account or segregated cash account, or provide an irrevocable stand-by letter of credit payable to the commission in an amount sufficient to cover 100% of the REPs outstanding customer deposits and residential advance payments held at the close of each month.

(B) A REP certified pursuant to paragraph (1)(B) of this subsection shall keep customer deposits and residential advance payments in an escrow account or segregated cash account, or provide an irrevocable stand-by letter of credit payable to the commission in an amount sufficient to cover 100% of the REP's outstanding customer deposits and residential advance payments held at the close of each month. For purposes of this subparagraph only, to qualify as a segregated cash account, the account must be with a financial institution whose deposits, including the deposits in the segregated cash account, are insured by the Federal Deposit Insurance Corporation, the account is designated as containing only customer deposits, the account is subject to the control or management of

a provider of pervasive and comprehensive credit to the REP that is not affiliated with the REP, and the terms for managing the account protect customer deposits.

- (C) In lieu of the requirements of subparagraph (B) of this paragraph, a REP certified pursuant to paragraph (1)(B) of this subsection that is providing electric service under the provisions of §25.498 of this title (relating to Retail Electric Service Using a Customer Prepayment Device or System) shall be required to keep all deposits and an amount sufficient to cover the credit balance that exceeds \$50 for all customer accounts that have a credit balance exceeding \$50 at the close of each month in an escrow account, or to provide an irrevocable stand-by letter of credit payable to the commission in an amount equal to or greater than the amount required to be deposited in the escrow account.
- (D) Each escrow account and segregated cash account shall be reconciled no less frequently than at the close of each month to ensure that it equals or exceeds deposits and residential advance payments held as of the end of the month, and shall maintain at least that amount in the account until the next monthly reconciliation.
- (E) Any irrevocable stand-by letter of credit provided pursuant to this paragraph shall be in addition to the irrevocable stand-by letter of credit required by paragraph (1)(B) of this subsection, if applicable.

(3) **Protection of TDU financial integrity.**

(A) A TDU shall not require a deposit from a REP except to secure the payment of transition charges as provided in §25.108 of this title (relating to Financial Standards for Retail Electric Providers Regarding Billing and Collection of Transition Charges), or if the REP has defaulted on one or more payments to the TDU. A TDU may impose credit conditions on a REP that has defaulted to the extent specified in its statewide standardized tariff for retail delivery service and as allowed by commission rules.

(B) A TDU shall create a regulatory asset for bad debt expenses, net of collateral posted pursuant to subparagraph (A) of this paragraph and bad debt already included in its rates, resulting from a REP's default on its obligation to pay delivery charges to the TDU. Upon a review of reasonableness and necessity, a reasonable level of amortization of such regulatory asset shall be included as a recoverable cost in the TDU's rates in its next rate case or such other rate recovery proceeding as deemed necessary.

(4) **Financial documentation required to obtain a REP certificate.** The following shall be required to demonstrate compliance with the financial requirements to obtain a REP certificate.

(A) Investment-grade credit ratings shall be documented by reports of a credit reporting agency.

(B) Tangible net worth shall be documented by the audited financial statements of the REP or its guarantor for the most recently completed

calendar or fiscal year, and unaudited financial statements for the most recently completed quarter. Audited financial statements shall include the accompanying notes and the independent auditor's report. Unaudited financial statements shall include a sworn statement from an executive officer of the REP attesting to the accuracy, in all material respects, of the information provided in the unaudited financial statements. Three consecutive months of monthly statements may be submitted in lieu of quarterly statements if quarterly statements are not available. The requirement for financial statements may be satisfied by filing a copy of or by providing an electronic link to its most recent statement that contains unaudited financials filed with any agency of the federal government, including without limitation, the Securities and Exchange Commission.

- (C) Shareholders' equity shall be documented by the audited and unaudited financial statements of the REP for the most recent quarter. Audited financial statements shall include the accompanying notes and the independent auditor's report. Unaudited financial statements shall include a sworn statement from an executive officer of the REP attesting to the accuracy, in all material respects, of the information provided in the unaudited financial statements. Three consecutive months of monthly statements may be submitted in lieu of quarterly statements if quarterly statements are not available. The requirement for financial statements may be satisfied by filing a copy of or by providing an electronic link to its most recent statement that contains unaudited financials filed with any

agency of the federal government, including without limitation, the Securities and Exchange Commission.

- (D) Segregated cash accounts shall be documented by an account statement that clearly identifies the financial institution where the account holder maintains the account, and that clearly identifies the account as an account that is designated as containing only customer deposits and residential advanced payments. Segregated cash accounts shall be maintained at a financial institution that is supervised or examined by the Board of Governors of the Federal Reserve System, the Office of the Controller of the Currency, or a state banking department, and where accounts are insured by the Federal Deposit Insurance Corporation.
- (E) Escrow accounts shall be documented by the current account statement and the escrow account agreement. The escrow account agreement shall provide that the account holds customer deposits and residential advance payments only, and that the deposits are held in trust by the escrow agent and are not the property of the REP or in the REP's control unless the customer deposits are applied to a final bill or applied to satisfy unpaid amounts if allowed by the REP's terms of service. The escrow agent shall deposit the customer deposits and residential advance payments in an account at a financial institution that is supervised or examined by the Board of Governors of the Federal Reserve System, the Office of the Controller of the Currency, or a state banking department, and where accounts are insured by the Federal Deposit Insurance Corporation.

- (F) Irrevocable stand-by letters of credit provided pursuant to paragraphs (1) or (2) of this subsection must be issued by a financial institution that is supervised or examined by the Board of Governors of the Federal Reserve System, the Office of the Controller of the Currency, or a state banking department, and where accounts are insured by the Federal Deposit Insurance Corporation. The REP must use the standard form irrevocable stand-by letter of credit approved by the commission. The irrevocable stand-by letter of credit must be irrevocable for a period not less than twelve months, payable to the commission, and must permit the commission's executive director to draw on the irrevocable stand-by letter of credit at such time that a mass transition of the REP's customers is carried out by ERCOT or any time thereafter, and permit a draw to be made in part or in full.
- (G) A REP may satisfy the requirements of paragraph (1)(A) of this subsection by relying upon a guarantor that meets one of the capital requirements of paragraph (1)(A) of this subsection, provided that:
- (i) The guarantor is an affiliate of the REP and has executed and maintains the standard form guaranty agreement approved by the commission, or
 - (ii) The guarantor is one or more persons that are affiliates of the REP and such affiliates have executed and maintain guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or

collateral requirements associated with power purchase agreements and for security associated with participation at ERCOT, or

(iii) The guarantor is a financial institution that maintains an investment-grade credit rating and has executed and maintains guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or collateral requirements associated with power purchase agreements and for security associated with participation at ERCOT, or

(iv) The guarantor is a provider of wholesale power supply to the REP, or one of such power provider's affiliates, and such person has executed and maintains guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or collateral requirements associated with a power purchase agreement and for security associated with participation at ERCOT.

(5) **Billing and collection of transition charges.** If a REP serves customers in the service area of a TDU that is subject to a financing order pursuant to PURA §39.310, the REP shall comply with §25.108 of this title.

(6) **Proceeds from an irrevocable stand-by letter of credit.**

(A) Proceeds from an irrevocable stand-by letter of credit provided under this subsection may be used to satisfy the following obligations of the REP, in the following order of priority:

- (i) first, to pay the deposits to retail electric providers that volunteer to provide service in a mass transition event under §25.43 of this title (relating to Provider of Last Resort) of low income customers enrolled in the system benefit fund rate reduction program pursuant to §25.454(f) of this title (relating to Rate Reduction Program);
 - (ii) second, to pay the deposits to retail electric providers that do not volunteer to provide service in a mass transition event under §25.43 of this title of low income customers enrolled in the system benefit fund rate reduction program pursuant to §25.454(f) of this title;
 - (iii) third, for customer deposits and residential advance payments of customers that did not benefit from clause (i) or (ii) of this subparagraph;
 - (iv) fourth, for services provided by the independent organization related to serving customer load;
 - (v) fifth, for services provided by a TDU; and
 - (vi) sixth, for administrative penalties assessed under Chapter 15 of PURA.
- (B) Proceeds from an irrevocable stand-by letter of credit provided under this subsection shall, to the extent that the proceeds are not needed to satisfy an obligation set out in subparagraph (A) of this paragraph, be paid to the REP.

(g) **Technical and managerial requirements.** A REP must have the technical and managerial resources and ability to provide continuous and reliable retail electric service to customers, in accordance with its customer contracts, PURA, commission rules, ERCOT protocols, and other applicable laws.

(1) Technical and managerial resource requirements include:

- (A) Capability to comply with all applicable scheduling, operating, planning, reliability, customer registration, and settlement policies, protocols, guidelines, procedures, and other rules established by ERCOT or other applicable independent organization including any independent organization requirements for 24-hour coordination with control centers for scheduling changes, reserve implementation, curtailment orders, interruption plan implementation, and telephone number, fax number, e-mail address, and postal address where the REP's staff can be directly reached at all times.
- (B) Capability to comply with the registration and certification requirements of ERCOT or other applicable independent organization and its system rules, or contracts for services with entities registered with or certified by ERCOT or other applicable independent organization.
- (C) Compliance with all renewable energy portfolio standards in accordance with §25.173 of this title (relating to Goal for Renewable Energy).
- (D) Principals or permanent employees in managerial positions whose combined experience in the competitive electric industry or competitive

gas industry equals or exceeds 15 years. An individual that was a principal of a REP that experienced a mass transition of the REP's customers to POLR shall not be considered for purposes of satisfying this requirement, and shall not own more than 10% of a REP or directly or indirectly control a REP.

- (E) At least one principal or permanent employee who has five years of experience in energy commodity risk management of a substantial energy portfolio. Alternatively, the REP may provide documentation demonstrating that the REP has entered into a contract for a term not less than two years with a provider of commodity risk management services that has been providing such services for a substantial energy portfolio for at least five years. A substantial energy portfolio means managing electricity or gas market risks with a minimum value of at least \$10,000,000.
- (F) Adequate staffing and employee training to meet all service level commitments.
- (G) The capability and effective procedures to be the primary point of contact for retail electric customers for distribution system service in accordance with applicable commission rules, including procedures for relaying outage reports to the TDU on a 24-hour basis.
- (H) A customer service plan that describes how the REP complies with the commission's customer protection and anti-discrimination rules.

- (2) An applicant shall include the following in its initial application for REP certification:
- (A) Prior experience of one or more of the applicant's principals or permanent employees in the competitive retail electric industry or competitive gas industry;
 - (B) Any complaint history, disciplinary record and compliance record during the 60 months immediately preceding the filing of the application regarding: the applicant; the applicant's affiliates that provide utility-like services such as telecommunications, electric, gas, water, or cable service; the applicant's principals; and any person that merged with any of the preceding persons;
 - (i) The complaint history, disciplinary record, and compliance record shall include information from any federal agency including the U.S. Securities and Exchange Commission; any self-regulatory organization relating to the sales of securities, financial instruments, or other financial transactions; state public utility commissions, state attorney general offices, or other regulatory agencies in states where the applicant is doing business or has conducted business in the past including state securities boards or commissions, the Texas Secretary of State, Texas Comptroller's Office, and Office of the Texas Attorney General. Relevant information shall include the type of complaint, status of

- complaint, resolution of complaint, and the number of customers in each state where complaints occurred.
- (ii) The applicant may request to limit the inclusion of this information if it would be unduly burdensome to provide, so long as the information provided is adequate for the commission to assess the applicant's and the applicant's principals' and affiliates' complaint history, disciplinary record, and compliance record.
 - (iii) The commission may also consider any complaint information on file at the commission.
- (C) A summary of any history of insolvency, bankruptcy, dissolution, merger, or acquisition of the applicant or any predecessors in interest during the 60 months immediately preceding the application;
 - (D) A statement indicating whether the applicant or the applicant's principals are currently under investigation or have been penalized by an attorney general or any state or federal regulatory agency for violation of any deceptive trade or consumer protection laws or regulations;
 - (E) Disclosure of whether the applicant or applicant's principals have been convicted or found liable for fraud, theft, larceny, deceit, or violations of any securities laws, customer protection laws, or deceptive trade laws in any state;
 - (F) An affidavit stating that the applicant will register with or be certified by ERCOT or other applicable independent organization and will comply with the technical and managerial requirements of this subsection; or that

entities with whom the applicant has a contractual relationship are registered with or certified by the independent organization and will comply with all system rules established by the independent organization; and

(G) Other evidence, at the discretion of the applicant, supporting the applicant's plans for meeting requirements of this subsection.

(h) **Customer protection requirements.** A REP shall comply with all applicable customer protection requirements, including disclosure requirements, marketing guidelines and anti-discrimination requirements, and the requirements of this section.

(i) **Requirements for reporting and changing certification.** To maintain a REP certificate, a REP must keep its certification information up to date, pursuant to the following requirements:

(1) A REP shall notify the commission within five working days of any change in its business address, telephone numbers, authorized contacts, or other contact information.

(2) A REP that demonstrates compliance with certification requirements of this section by submitting an affidavit shall supply information to the commission to show actual compliance with this section.

(3) A REP shall apply to amend its certification within ten working days of a material change to the information provided as the basis for the commission's approval of the certification application. A REP may seek prior approval of a material change, including a change in control, by filing the amendment application before

the occurrence of the material change. The transfer of a REP certificate is a material change.

- (4) For an Option 1 REP, the REP shall notify the commission within three working days of its non-compliance with subsection (f)(1)(A) or (f)(1)(B) of this section. The notification shall set out a plan of recourse to correct the non-compliance with subsection (f)(1)(A) or (f)(1)(B) of this section within 10 working days after the non-compliance has been brought to the attention of the commission. The commission staff may initiate a proceeding to address the non-compliance.
- (5) For an Option 1 REP, the REP shall file a report due on March 5, or 65 days after the end of the REP or guarantor's fiscal year (annual report), and August 15, or 225 days after the end of the REP or guarantor's fiscal year (semi-annual report), of each year.
 - (A) The annual report shall include:
 - (i) Any changes in addresses, telephone numbers, authorized contacts, and other information necessary for contacting the certificate holder.
 - (ii) Identification of areas where the REP is providing retail electric service to customers in Texas compiled by zip code.
 - (iii) A list of aggregators with whom the REP has conducted business in the reporting period, and the commission registration number for each aggregator.
 - (iv) A sworn affidavit that the certificate holder is not in material violation of any of the requirements of its certificate.

- (v) Any changes in ownership.
 - (vi) Any changes in management, experience, and personnel relied on for certification in each semi-annual report before the REP begins serving customers and in the first semi-annual report after the REP serves customers.
 - (vii) Documentation to demonstrate ongoing compliance with the financial requirements of subsection (f) of this section, including, but not limited to, calculations showing tangible net worth, financial ratios or shareholders' equity, as applicable, and the amount of customer deposits and the balance of an account in which customer deposits are held, supported by a sworn statement from an executive officer of the REP attesting to the accuracy, in all material respects, of the information provided. Any certified calculations provided as part of the annual report to demonstrate such compliance shall be as of the end of the most recent fiscal quarter. A REP may submit any relevant documentation of the type required by subsection (f)(4) of this section to demonstrate its ongoing compliance with the financial requirements of subsection (f) of this section.
- (B) The semi-annual report shall include:
- (i) Documentation to demonstrate ongoing compliance with the financial requirements of subsection (f) of this section, including, but not limited to, calculations showing tangible net worth,

financial ratios or shareholders' equity, as applicable, and the amount of customer deposits and the balance of an account in which customer deposits are held, and shall be supported by a sworn statement from an executive officer of the REP attesting to the accuracy of the information provided. Any certified calculations provided as part of the semi-annual report to demonstrate such compliance shall be as of the end of the most recent fiscal year and most recent fiscal quarter. A REP may submit any relevant documentation of the type required by subsection (f)(4) of this section to demonstrate its ongoing compliance with the financial requirements of subsection (f) of this section.

- (ii) The audited financial statements of the REP or its guarantor for the most recent completed calendar or fiscal year with accompanying footnotes and the independent auditor's report, if not previously filed.
- (iii) The unaudited financial statements for the most recent six-month financial period that immediately follows the end of its most recent fiscal year. Unaudited financial statements shall include a sworn statement from an executive officer of the REP attesting to the accuracy, in all material respects, of the information provided in the unaudited financial statements. In lieu of six-month unaudited

financial statements, six consecutive months of monthly financial statements may be submitted.

- (C) The requirement for financial statements may be satisfied by filing a copy of or by providing an electronic link to its most recent statement that contains unaudited financials filed with any agency of the federal government, including without limitation, the Securities and Exchange Commission. A REP that is part of a structure that is consolidated for financial reporting purposes and files financial reports with a federal agency on a consolidated company basis may provide financial statements for the consolidated company to meet this requirement.
 - (D) REPs or guarantors with an investment-grade credit rating are not required to provide financial statements pursuant to this section.
- (6) A REP shall not cease operations as a REP without prior notice of at least 45 days to the commission, to each of the REP's customers to whom the REP is providing service on the planned date of cessation of operations, and to other affected persons, including the applicable independent organization, TDUs, electric cooperatives, municipally owned utilities, generation suppliers, and providers of last resort. The REP shall file with the commission proof of refund of any monies owed to customers. Upon the effective cessation date, a REP's certificate will be suspended. A REP must demonstrate full compliance with the requirements of this section, including but not limited to, the requirement to demonstrate shareholders' equity of not less than one million dollars and its associated restrictions pursuant to subsection (f)(1)(B) of this section, in order for the

commission to reinstate the certificate. The commission may revoke a suspended certificate if it determines that the REP does not meet certification requirements.

- (7) If a REP files a petition in bankruptcy, is the subject of an involuntary bankruptcy proceeding, or in any other manner becomes insolvent, it shall notify the commission within three working days of this event and shall provide the commission a summary of the nature of the matter. The commission shall have the right to proceed against any financial resources that the REP relied on in obtaining its certificate, to satisfy unpaid obligations to customers or administrative penalties.
- (8) A REP shall respond within three working days to any commission staff request for additional information to confirm continued compliance with this section.
- (j) **Suspension and revocation.** A certificate granted pursuant to this section is subject to amendment, suspension, or revocation by the commission for a significant violation of PURA, commission rules, or rules adopted by an independent organization. A suspension of a REP certificate requires the cessation of all REP activities associated with obtaining new customers in the state of Texas. A revocation of a REP certificate requires the cessation of all REP activities in the state of Texas, pursuant to commission order. The commission may also impose an administrative penalty on a person for a significant violation of PURA, commission rules, or rules adopted by an independent organization. The commission staff or any affected person may bring a complaint seeking to amend, suspend, or revoke a REP's certificate. Significant violations include the following:

- (1) Providing false or misleading information to the commission;
- (2) Engaging in fraudulent, unfair, misleading, deceptive, or anticompetitive practices, or unlawful discrimination;
- (3) Switching, or causing to be switched, the retail electric provider for a customer without first obtaining the customer's permission;
- (4) Billing an unauthorized charge, or causing an unauthorized charge to be billed, to a customer's retail electric service bill;
- (5) Failure to maintain continuous and reliable electric service to customers pursuant to this section;
- (6) Failure to maintain financial resources in accordance with subsection (f) of this section;
- (7) Bankruptcy, insolvency, or the inability to meet financial obligations on a reasonable and timely basis;
- (8) Failure to timely remit payment for invoiced charges to an independent organization;
- (9) Failure to observe any applicable scheduling, operating, planning, reliability, and settlement policies, protocols, guidelines, procedures, and other rules established by the independent organization;
- (10) A pattern of not responding to commission inquiries or customer complaints in a timely fashion;
- (11) Suspension or revocation of a registration, certification, or license by any state or federal authority;

- (12) Conviction of a felony by the certificate holder, a person controlling the certificate holder, or principal employed by the certificate holder, or any crime involving fraud, theft, or deceit related to the certificate holder's service;
 - (13) Not providing retail electric service to customers within 24 months of the certificate being granted by the commission;
 - (14) Failure to serve as a provider of last resort if required to do so by the commission;
 - (15) Providing retail electric service in an area in which customer choice is in effect without obtaining a certificate under this section;
 - (16) Failure to timely remit payment for invoiced charges to a transmission and distribution utility pursuant to the terms of the statewide standardized tariff adopted by the commission; and
 - (17) Other significant violations, including the failure or a pattern of failures to meet the requirements of this section or other commission rules or orders.
- (k) **Phase-in provisions.**
- (1) A REP that obtained certification pursuant to this section before the effective date of this section and does not meet all of the requirements of this section may continue to operate as a REP for not more than 12 months after the effective date of this section.
 - (2) A REP that cannot meet the requirements of this section shall meet the requirements of the this section as it was in effect on April 22, 2009 until it notifies the commission that it meets the requirements of this section and provides documentation to substantiate the notification.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that the repeal and adoption of new §25.107 relating to Certification of Retail Electric Providers is hereby adopted with changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS this the 1st day of MAY 2009.

PUBLIC UTILITY COMMISSION OF TEXAS

BARRY T. SMITHERMAN, CHAIRMAN

DONNA L. NELSON, COMMISSIONER

KENNETH W. ANDERSON, JR., COMMISSIONER