STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 15-M-0127 – In the Matter of Eligibility Criteria for Energy Service Companies.

Case 12-M-0476 – Proceeding on Motion of the Commission to Assess Certain Aspects of the Residential and Small Non-residential Retail Energy Markets in New York State.

Case 98-M-1343 – In the Matter of Retail Access Business Rules.

STAFF WHITEPAPER REGARDING ESCO PERFORMANCE BONDS OR OTHER SECURITY INTERESTS

Dated: May 4, 2016

INTRODUCTION AND BACKGROUND

The Commission has taken a number of actions to improve retail access markets for residential and small non-residential (mass market) customers. In its Order Resetting Retail Energy Markets and Establishing Further Process, the Commission limited energy service company (ESCO) enrollment or renewal of mass market customers to contracts that guarantee savings in comparison to what the customer would have paid as a full service utility customer, or that provide at least 30% renewable electricity.[1] The Order also sets forth for consideration certain new requirements applicable to ESCOs, including whether and under what circumstances ESCOs should be required to post performance bonds or other forms of demonstrated financial capability.

The Uniform Business Practices (UBPs) establish creditworthiness standards for ESCOs.[2] An ESCO's participation in a utility's retail access program is contingent upon satisfaction of creditworthiness requirements and provision of any required security. Creditworthiness standards generally involve maintaining a minimum credit rating from one of the major rating agencies or the ESCO entering into a billing arrangement with the distribution utility, whereby the distribution utility bills customers on behalf of the ESCO and retains the funds it collects to offset any balancing and billing service charges (Purchase of Receivables, or POR, program.) The POR program requires an agreement between the ESCO and the distribution utility (Billing Services Agreement) whereby the distribution utility has a priority security

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[1] Cases 15-M-0127, et al., In the Matter of Eligibility Criteria for Energy Service Companies, Order Resetting Retail Energy Markets and Establishing Further Process (issued February 23, 2016). Portions of this order are stayed pending judicial review.

[2] Uniform Business Practices, Section 3.

interest with a first right of access to all of the ESCOs accounts receivable arising out of the ESCO charges billed by the utility.

A performance bond is a particular type of surety bond that guarantees to pay the recipient a certain amount of if the principal fails to meet a specified obligation, such as fulfilling the terms of a contract. Performance bonds serve to guarantee performance and completion of the terms of a contract, and help demonstrate the credibility of contractors. Commonly used in the construction industry, performance bonds have been required in the past by the New York State Board on Electric Generation Siting and the Environment, in connection with Article 10 proceedings to authorize the construction of major electric generating facilities.

In a Notice issued on February 23, 2016, parties were invited to submit comments on several such conditions, including "[w]hether and under what circumstances ESCOs should be required to post performance bonds or other forms of demonstrated financial capability. If so, what magnitude is appropriate and how can this be administered most efficiently?"[3] The Comments received on the issue of performance bonds are summarized below.

PARTY COMMENTS

Several ESCOs supported the imposition of a reasonable performance bond or similar financial security instrument and stated the magnitude of the security instrument could be based on a variety of factors, including the amount of customers the ESCO serves, the quantity of energy the ESCO sells, the ESCO revenues or the ESCO's performance in other markets. Some ESCOs believe the performance bond requirement

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[3] Cases 15-M-0127, et al., supra, Notice Seeking Comments On Resetting Retail Energy Markets For Mass Market Customers (issued February 23, 2016).

should differ depending on the modes of marketing, while other ESCOs disagree.

Other ESCOs commented that if a company can provide evidence that it has the financial capability to satisfy any fines and/or penalties, it should be allowed that opportunity before a performance bond would be exercised. Further, if a performance bond is exercised, some ESCOs offer that there should be safeguards to ensure that the proceeds are administered in an unbiased manner after sufficient knowledge of the market participant's products, pricing and guarantees are obtained.

Direct Energy supports a financial assurance requirement, stating that New Yorkers need a clear signal that ESCOs who operate in New York have the financial wherewithal both to keep the promises they make to their customers and to make things right if they ever fall short. Direct Energy's proposes a two tiered approach: $1 million for ESCOs serving mass market customers who certify that they are not engaged in door-to-door or outbound telemarketing sales to mass market customers, and $3 million for ESCOs serving mass market customers who do plan to use those sales channels.

Some ESCOs suggest that, if the Commission were to impose additional financial requirements, letters of credit be acceptable and that any financial requirements be in line with other jurisdictions. Some ESCOs support the concept of requiring ESCOs to post a bond or other form of financial capability so long as the bond level is not set so high as to exclude small companies that have innovative business models. Others believe the performance bond requirements should be applied prospectively and should not apply to ESCOs that have demonstrated to be sufficiently credible through their participation in the market.

New York State Energy Marketers Coalition supports a comprehensive ESCO certification process which would include an initial and annual certification fee, established at a significant yet reasonable level (for example, $2,500 per year). In addition, a reasonable demonstration of financial assurance (through a wide array of resources, including corporate guaranty, letter of credit or posted bond) should be required for every ESCO, with consideration given to the relative size of the ESCO. This assurance should relate specifically to the ESCO's performance in fulfilling its own contract.

The Retail Energy Supply Association (RESA) recommends that performance bonds should be made payable to the Commission, rather than to utilities, since the Commission is in the best position to ensure customer protections. Further, the method for posting the bonding requirement should remain flexible to allow ESCOs to select from a range of possibilities that will best meet their business needs. With respect to the amount of bond posted, a minimum requirement should be established for all ESCOs in the market, with additional considerations made based on an ESCO's market share and business reputation. Consideration should be given to reducing or waiving the bond for ESCOs that have a history of compliance with the UBP and Commission orders.

Supreme Energy, Inc. (Supreme) sees no circumstance in which utility holding of performance bonds would be warranted or helpful to the market or to customers. The Commission, as the neutral party charged with protecting the interests of the customers and answerable to the citizens of the State of New York, is the appropriate entity to exercise these instruments for the protection of those customers and citizens.

The Utility Intervention Unit of The New York State Department of State (UIU) states that the Commission should require ESCOs to post performance bonds in order to ensure their ability to sufficiently satisfy fines or judgments that may reasonably be assessed against them. Such a performance bond would provide an accountability measure to ensure the price savings guarantee and other elements of the Reset Order can be properly enforced. Rather than proposing the specific contours of a performance bond, UIU recommends instead the Commission consider certain principles when developing the features of such a bond, including protection of customers as the primary purpose of the bond, establishing the amount of the bond based on the nature of the ESCO's business, and ensuring that the bond is substantial enough so as to afford ESCO customers a high degree of security.

DISCUSSION AND CONCLUSION

The Commission will consider additional creditworthiness criteria in the context of ESCO eligibility. In addition, as many ESCOs point out in comments, security is required by the utility, the ISO and the gas pipelines. However, the security requirements that are the subject of this proposal are intended to serve a distinct purpose, and are necessary to ensure an ESCO's ability to, at a minimum, ensure the price savings guarantee and other elements of the Reset Order. The additional security requirements should apply to ESCOs that are serving mass market customers and should be based on the number of customers the ESCO serves, the annual revenues, or the quantity of electric or gas provided to customers. Below are several proposals which Staff offers as examples of ways in which a performance bond or security instrument could be calculated.

First, the amount of a performance bond or security instrument could be set annually, based on the number of customers served by an ESCO and the average charges in excess of what the utility would have charged in a prior period. This customer focused approach would utilize historic data to determine the average amount customers paid for service from an ESCO in excess of what would have been paid to the utility, and then multiplies that amount by the number of customers a particular ESCO is serving. Further, the level of security could be moderated based on an ESCOs historic performance as well as complaint levels.

Second, another option would be to calculate the performance bond or security instrument based only on the number of customers served. This approach would establish tiers based on the number of customers served and would require higher bonds for larger customer bases.

Similar to this approach, the performance bond or security instrument could also be based on the amount of load served by the ESCO. This method will also likely utilize a tiered system where larger bonds will be required for higher levels of load. Whether based on number of customers or the size of the load served, the amount of the performance bond or security instrument can be updated on an annual basis.

Third, the performance bond or security instrument could be based on the percentage of annual revenues of the ESCO. For example, an ESCO may be required to post a performance bond or security instrument each year, in an amount equal to 10 percent of the ESCO's annual revenues for commodity sales in the prior calendar year.

Other options include basing the amount of a performance bond or security instrument on the type of customers served, simply establishing a flat amount that all ESCOs are required to post regardless of the size of the ESCO or number of customers served, or any combination of the examples provided above.

The Commission is also considering the use of the existing Purchases of Receivables (POR) discount or supplementing existing utility creditworthiness criteria. Under the POR Model, utilities provide billing and collection services for the vast majority of ESCOs serving residential customers and then purchase the accounts receivable from most of the ESCOs providing service to mass market customers. The value of the receivables purchased is generally discounted based on historical net write off percentages. Depending on the utility, the POR discount rate is reset periodically or at the time new rates are set. The POR discount could be increased to include a component related to the guaranteed savings commitment and the utility could establish a fund to be used in a similar fashion that a performance bond or security instrument would be used.

We are seeking comments on what other security instruments or options make sense, in light of the Commission’s goal to supplement existing creditworthiness criteria, for the purpose of ensuring an ESCOs ability to provide a price guarantee to customers.