PROJECT NO. 35767

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

COMMENTS OF TXU ENERGY RETAIL COMPANY LLC IN RESPONSE STAFF'S QUESTIONS RELATING TO THE CERTIFICATION OF RETAIL ELECTRIC PROVIDERS

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

TXU Energy Retail Company LLC ("TXU Energy") respectfully submits the following comments regarding the Public Utility Commission of Texas ("Commission") Staff's Questions in Project 35767, *Rulemaking Relating to the Certification Retail Electric Providers*.

I. INTRODUCTION

TXU Energy applauds the Commission for opening this and the related rulemaking regarding the provider of last resort ("POLR")[1] and appreciates the opportunity to submit comments. In answering the questions posed in this rulemaking, TXU Energy is guided by two overarching principles. As a first principle, TXU Energy submits that the Commission's rules regarding minimum requirements for retail electric providers (REPs) should be designed primarily to protect the customer and the customer's right to choose a retailer who provides products and services that meet their needs. The customer's exercise of his or her right to choose should be insulated, to the extent reasonably possible, from the risk that the REP will lack the resources to satisfy deposit and load requirements, or will fail to honor its commitments and representations to the customer. After the customer is protected, the rules should next protect the REPs, including the POLRs, that have not violated the rules or failed to honor their commitments and representations. Only lastly – and only to the extent it harms neither the customer nor other REPs – should the rules be designed or applied to protect the REP that has violated the rules or has failed to honor its commitments and representations.

[1] Project No. 35769, *Rulemaking Relating To Providers Of Last Resort.*

The recent failures of some REPs have revealed that the operation of the current rules has afforded the failing REP the luxury of the protection provided by customer deposits – essentially holding the customer to his or her end of the bargain, even as the failing REP did not live up to its end of the bargain – often to the detriment of the customer and to the POLR REP that is required under the Commission's POLR rules to ensure that customers continue to receive electric service without interruption –the primary goal of POLR service. Consequently, customers lost the benefit of their contracts with their previous providers through no fault of their own. And the POLR REPs, also through no fault of their own, were too frequently neither protected by deposits nor paid for electric service they provided to customers in trust and on credit, to ensure the customers' service was not interrupted. Importantly, this scenario in which REPs acting as POLR have been exposed to unexpectedly higher levels of bad debt undermines another important goal of POLR service – to quarantine the financial strain of the defaulting REP and prevent any 'domino-type' series of REP defaults. While such an extreme illustration has thankfully not come to pass, its mere potential and the ensuing widespread customer impact that such an event would create is enough to warrant diligent consideration. TXU Energy is hopeful that reordering these priorities will be one of the outcomes of this and the related rulemaking. However, TXU Energy submits that the Commission's actions should be balanced to avoid additional REP costs that will ultimately likely be borne by customers through higher prices.

The second overarching principle is that one size might not fit all in the REP certification context. Indeed, the Commission seemed to recognize this to some extent the last time this rule was amended, crafting different rules for differently sized REPs. As discussed below, TXU Energy suggests that it may be possible to distinguish among REPs in a couple of different meaningful ways. First, the Commission could scale the financial requirements based on a REP's size, probably best measured by some proxy for load.

Second, it may be possible to craft either some type of "early warning system" ("EWS") that can be used to identify REPs that may be imperiled or at risk of failure, and/or to impose a probationary period on all new REPs. While the rule should consider a balance of the use of an EWS or probationary period to ensure there is not a "run on the bank" (i.e., unfairly alarming customers, driving them to switch and actually precipitating REP failure), REPs meeting this EWS criteria or subject to a probationary period could confidentially be subjected to more stringent requirements, review, and supervision to protect customers who might be affected, without burdening all REPs (and the Commission) with the onus of unnecessary regulation and scrutiny. Thus, it is important that any additional requirements placed upon a REP meeting any EWS criteria not create significant additional financial burdens that may only serve to hasten and make more likely a default and thereby reduce or even eliminate the potential benefit that an EWS might provide.

TXU Energy notes that an EWS is not a panacea. Indeed, it is likely that, even if an EWS had been in place, the recent REP failures would not have been detected adequately in advance to avoid the mass transitions to POLR and consequent customer disappointment. Moreover, the determination of the appropriate criteria poses a significant challenge. Finally, considerable work would need to be done to balance the actions taken to protect the customers without triggering a loss of confidence in the REP. Nonetheless, the concept has enjoyed at least some success in other contexts and should be explored.

II. STAFF'S QUESTIONS

Question 1: Should the financial qualifications for REPs require cash-like assets that can be readily applied to the REP's obligations to refund customer deposits and advance payments and obligations to TDUs, such as posting letters of credit (LOC) or obtaining surety bonds? Should creditworthy REPs (investment-grade) be exempt from any LOC or surety bond requirements, and allowed to continue to maintain customer deposits in restricted cash accounts?

TXU Energy supports the requirement of "cash-like assets", assuming that "cash-like assets" refers to the instruments currently described in P.U.C. SUBST. R. 25.107(f)(1)(C). Currently, REPs can satisfy this requirement in a variety of ways, other than letters of credit or surety bonds. Limiting REPs to only cash, letters of credit ("LOCs"), or surety bonds, would require significant changes in the way many REPs satisfy the requirements and substantially increase the cost of providing retail service, and could prohibit the use of instruments that provide adequate protection at lesser cost. Moreover, even among the instruments listed in Staff's question, there are considerable differences. For example, surety bonds can be more difficult to enforce than irrevocable LOCs.

TXU Energy also agrees that, if an LOC or surety bond requirement is imposed on some REPs, creditworthy REPs should be exempt. However, relying on whether or not a REP is "investment grade" is not necessarily the best way to identify those REPs that are creditworthy, as the current credit crisis demonstrates. TXU Energy would encourage the Commission to solicit input regarding the ways in which creditworthiness might be measured. As discussed below, one possibility would be to apply different requirements to REPs that have triggered an EWS.

With respect to REPs' obligations to the TDUs, TXU Energy submits that the additional cost of providing LOCs or surety bonds for normal wires charges needs to weighed against the benefits of providing TDUs the additional security afforded by those instruments.

Question 2: The commission has drawn funds from a LOC through the contested-case process. In one case, it took approximately six months to draw on the LOC and return deposits to customers. By comparison, ERCOT has the ability to draw on an LOC and distribute the funds to damaged parties in a matter of days. How could the commission expedite a draw of funds from an LOC? Is additional authority required for the commission to draw funds from a LOC immediately?

TXU Energy assumes that the contested case process itself constrains the Commission relative to ERCOT's process. A review and comparison of the ways in which ERCOT has drawn on LOCs and how the Commission has proceeded might be useful. In addition, it may be possible to initiate a draw on the LOC before it becomes embroiled in a contested case. Perhaps the rule could specify that the Executive Director has the authority to initiate the draw on the LOC once ERCOT initiates the mass transition event. The Commission could also consider requiring the provider of the LOC to acknowledge the purpose of the LOC and the conditions under which the Commission may execute on the LOC, without the need for a contested case. Additional legislative authority could also allow the Commission to use other available funds to bridge the time delay, such as the ability to utilize excess System Benefit Fund dollars.

Question 3: Are there mechanisms or instruments other than LOCs and surety bonds that provide at least the same level of security as an LOC or surety bond? If so, please identify and describe the mechanism or instrument and how the commission can use it to protect customer deposits.

TXU Energy believes that the current requirements coupled with the changes suggested herein provide adequate security. That said, TXU Energy is not aware at this time of a mechanism or instrument that provides the same level of security as an LOC or surety bond, with the possible exception of some type of escrow agreement. However, because of the high cost of LOCs and surety bonds, and the relatively infrequent need for their availability, TXU Energy believes that the Commission should consider other options that provide a better balance of the risks and costs that would produce most of the desired results and protections without adding the high costs necessary to protect all customers from a threat that will likely affect only a small number of customers at any time. These other options might include measures currently listed in Subsection (f)(1)(C) and other methods such as a right of offset or resort to the system benefit fund.

The EWS or a probationary period might provide a basis for requiring some, but not all, REPs to use only LOCs and surety bonds. Under that approach, the REP could be prohibited from applying deposit funds against outstanding bills, and instead required to return the funds to the customer. Allowing the failing REP to retain and apply the customers' deposits seems to protect the failing REP at the expense of both the customer and the POLR.

Question 4: (a) Should TDUs be given greater latitude in managing REP credit risks, such as by allowing them to collect deposits from REPs? If so, should the TDUs' latitude to manage REP credit risk be limited in any way? If a REP is unable to pay a TDU, under current business processes, the TDU can be exposed to providing approximately 85 days of unpaid service. How much of this exposure should the TDU

be allowed to mitigate? Should creditworthy REPs be exempt from TDU deposit requirements? Should TDUs offer unsecured credit based on payment history?

(b) Alternatively, should the financial requirements of REPs be modified to so that TDUs are better protected from REP credit risks?

TXU Energy is willing to consider any alternatives that protect end use customers and balance the needs of all market participants. It should be pointed out that, as a POLR, TXU Energy is required to pay the TDU for both transition charges and wires charges, regardless of whether the customer pays TXU Energy. This has contributed to the POLRs' bad debt, because of the low rate of payment by customers recently transitioned to POLR service.

At the same time, TDUs may in fact have credit exposure when a REP leaves the market unexpectedly. TXU Energy is not aware that TDUs have identified the actual or expected losses or bad debt expense incurred by the recent REP failures, or the credit exposure going forward. Such learnings would help inform these proceedings.

Moreover, and given the complexity of bankruptcy law, it is not entirely clear that imposing on REPs the cost of deposits with TDUs will actually provide TDUs with the desired protection. While TXU Energy is sympathetic with these shortfalls, it does not diminish the need for the Commission to address the shortfall experienced by POLR REPs for providing electric service.

In the past, TDUs have also suggested alternative methods to protect credit exposure, such as a rider that would let the TDUs collect a bad debt expense arising from REP defaults. Other enhancements that might warrant consideration include a reasonable mechanism that allows the TDU to recover the REP-defaulted amount through deferred accounting treatment or a similar method, provided the POLR REPs also receive full recovery and customers are likewise protected.

Question 5: Should the billing cycle in the standard delivery tariff be shortened to limit exposure? If so, should REPs be permitted to use shorter billing cycles?

No, a monthly billing cycle has been the historical standard and changing it will require significant IT, billing transaction, and other costs for all market participants, as well as significant rulemaking changes. Pre-pay models already provide REPs flexibility in this regard.

Question 6: Based on your market experience, what is the appropriate minimum capital required for the initial start-up operation of a REP? The response should consider initial and near term liquidity needs for the purchase of wholesale electricity, collateral requirements, computer software and infrastructure, personnel, contract services, commodity risk management, marketing, and legal expenses. The response may include one scenario or a range of scenarios based on different market conditions, and should be supported with data where possible.

Currently, larger REPs face more stringent financial requirements than do smaller REPs. TXU Energy agrees with this question's implication that additional study may be required and that the Commission may want to impose a probationary period on new market entrants. Since the original $100,000 minimum capital requirement was set, two facts have emerged which directionally indicate higher minimum capital requirements are required – wholesale market prices are up substantially and market volatility has also increased, both primarily as a function of natural gas price movement, and the recent REP failures imply that the current $100,000 requirement apparently is not enough. One way of scaling the financial would be to base capital requirements (at lower, market-entrant-type) on the cost of serving the REP's load for one month, that would start with a minimum of $1,000,000 and would scale on a pro-rata customer basis until it reached the requirements currently in place for larger REPs. Alternatively, the Commission could impose a $1,000,000 minimum requirement, plus some measure of the REP's exposure, based on load. This amount could be scaled down as the REP increased in size and the extent to which the REP relied on the balancing energy segment and was subject to risks of MCPE price movements, declined. While this methodology is less relevant at higher customer counts, it could be used to bound the minimum capital requirements for small REPs.

Question 7: Should the financial standards for REP certification be divided into tiers, such that the creditworthiness of each REP and applicant is categorized into successive

tiers of qualification with higher financial requirements for companies with higher levels of exposure to market risks? Should such a tier system employ incentives for lower tier REPs to apply for and obtain higher tier status (or qualify for an automatic upgrade based on a periodic review) when warranted? Should exposure limits (load limits, customer deposit restrictions, etc.) be imposed on lower tier REPs?

Conceptually, TXU Energy agrees that creditworthiness, properly measured, and level of exposure to market risk are appropriate factors in determining financial requirements for REPs. TXU Energy suggests that a scalable formula would better match risk with requirements than tiers with essentially arbitrary size categories. Such an approach, tiered to scale, is described in response to Q6. However, there may be a way for small REPs to lower their scale by effectively 'netting' their customer count or load by making a voluntary showing that their risk management approach lowers exposure by matching customer sales and purchases. For example, a small REP with 20,000 customers, but with half their load effectively hedged with matched purchases, could scale to 10,000 customers.

Again, TXU Energy urges the Commission to explore the possibility of an EWS and/or a probationary period, and a range of requirements applicable only to REPs that are subject to probation or trigger the EWS.

Question 8: Should the revised rule incorporate limits on changes in exposure to market risks (load growth, restrictions on the offering of fixed price contracts to customers, or other restrictions designed to mitigate exposure to risk)? What requirements, including timing, should the rule set for updating financial qualifications consistent with growth in customer deposits and prepayments?

Many of the risks can not be effectively hedged in the wholesale market or even accurately anticipated through widely accepted backcasted risk management practices. Therefore, TXU Energy does not agree that the rules should incorporate limits on exposure such that the qualifying assets always match the risk. However to an extent that an EWS is derived, REPs that have triggered an EWS might therefore be required to report changes more promptly.

In addition, TXU Energy suggests that all REPs should be subject to the same timing requirements, with the possible exception of REPs that are on probation or have triggered an EWS and might therefore be required to report changes more promptly.

Question 9: Should there be separate financial standards for pre-pay REPs?

The recent failure of several pre-pay REPs suggests at first blush that this is perhaps advisable. However, many REPs may offer a variety of plans, including one or more pre-pay plans, and it might therefore be difficult to apply specific pre-pay requirements for the entity. In other words, a REP that offers pre-pay may also offer regular service and hence may not be a pure 'pre-pay REP'. This creates a dilemma of which regime (regular or pure play) the REP would certify under. Thus, it makes more sense to have a single regime.

Moreover, a REP that has been pre-paid appears to be in a position similar to a REP that has received a customer deposit in that it holds customer funds that it has not yet "earned" but instead holds against future consumption. Given this similarity, it appears unnecessary to have a separate set of financial requirements for REPs that offer pre-paid service. However, TXU Energy suggests additional analysis regarding differences in a customer's rights to recovery of pre-paid amounts and deposits.

Question 10: Should the commission consider key elements of a REP applicant's business plan, such as power acquisition, risk management, and retail pricing, in evaluating the financial requirements in an application for certification?

TXU Energy supports heightened requirements and scrutiny regarding technical and managerial requirements for REPs and a probationary period that allows for more oversight. However, the Commission should consider that one of the greatest benefits of competition is that it fosters innovation, and by actively screening and precluding untested and/or unconventional elements of a REP's business plan, the Commission could inadvertently hinder the development of the competitive electric retail business model.

The proposed probationary period could be applied to new REPs and to REPs that have triggered an EWS criteria. The probationary period would subject new REPS to PUC review by "appropriate office" until the REP has proven their business model. For a minimum 'probationary' period, say [2] years, the REP could be required to file confidential reports (15 days after the end of a month) on products sold, the prices, their procurement strategy, perhaps even including purchases info, customers and finances.

Question 11: Should REPs be required to submit quarterly financial reports? Should REPs be required to submit quarterly reports on power acquisition, risk management and their current retail contracts?

TXU Energy agrees that accurate, timely reporting of key facts is essential. TXU Energy suggests that the Commission seek input as to what key facts are indicative of potential REP failure, and the frequency with which such information should be reported. One possible consequence of triggering the EWS would be an increase in the reporting requirements and/or an increase in the frequency with which such reports are required. It may be that some issues for a troubled REP should be reported at least monthly, because financial changes can happen rapidly in a volatile market.

In addition to the challenge of indentifying the right issues to require REPs to report, is the challenge of how to deal with the information. First, some of the key information may be confidential to the REP. Moreover, the disclosure of the information, or of a REP becoming subject to additional requirements under the EWS mechanism, could cause a run on the REP and/or further increase the REP's cost of business, hastening and making more certain the REP's failure. On the other hand, customers should be protected from imperiled REPs. Balancing these competing interests will require regulatory finesse.

In any event, there does not appear to be a basis for imposing different and more stringent reporting requirements on larger REPs. With the possible exceptions of a probationary period and an EWS, all REPs should have the same reporting requirements.

Question 12: Should the commission disqualify owners, principals, and Board members of a company that has defaulted with ERCOT or a TDU or whose customers have been transferred in a mass transition from being an owner, principal, or Board member of another REP?

The outright disqualification of all owners, principals, and Board members of a failed company seems like too broad a response. It is possible, for example, that a particular individual was not responsible for the failure. It is also possible that an individual involved with a failed REP may actually be better equipped to enter the competitive retail market successfully than a new entrant, having learned from past mistakes. If the Commission seeks to disqualify individuals from the industry, perhaps a finding should be required in the certificate revocation proceeding that the person was at fault.

In the alternative, TXU Energy suggests that participation in a failed REP should be a factor in assessing a person's fitness for satisfying part or all of the managerial and technical requirements for REP certification.

Question 13: Should the technical requirements for REP certification be modified? What standards are appropriate?

Yes. The current requirements may not adequately require the employment of a sufficient number of individuals with experience in relevant areas, or a definition of what relevant expertise should be available, in areas such as invoicing, billing, ERCOT settlement, customer protection, risk, and risk management.

Question 14: Should the standards and procedures for certificate amendments and/or transfers be modified? If so, how?

Yes. The current rule and amendment form potentially leave open questions as to when amendment is required as opposed to notice. Moreover, it may be possible to read the current requirements as requiring an amendment when it seems that only notice should be required.

Question 15: Does the commission have the ability to prescribe by rule conditions that would result in automatic suspensions or revocations of REP Certificates? If so, should the rule allow for automatic suspensions or revocations of REP Certificates? Under what circumstances would an automatic suspension or revocation be appropriate? What process should the commission use to confirm automatic suspensions or revocations?

TXU Energy believes that the Commission has the authority to suspend or revoke a REP's certificate under a variety of circumstances, including those in which the Commission determines that the REP no longer has the financial or technical capability to provide continuous and reliable electric service. PURA § 39.356(a). However, this authority does not dispense with a party's right to due process. The question is: what process is due?

Because the term "automatic" might be viewed as suggesting that no process would be afforded the REP, this may raise due process issues. Intuitively, it seems that the process ought to make sense in the context of the problem to be solved or risk to be averted. Consequently, TXU Energy suggests that the Commission could and should have an abbreviated process that allows the Commission to quickly take such action as is reasonably necessary to protect consumers and the market. This may include suspension of a certificate or of some or all of a REP's rights and privileges under a certificate, and some presumptions. For example, it may be a reasonably rebuttable presumption that a REP no longer has the financial or technical capability to provide continuous and reliable electric service if its customers have been subject to a mass transfer to POLR. However, a REP is likely entitled to greater process before an outright and permanent revocation.

Question 16: If the commission adopts more stringent certification requirements, should it grandfather existing REPs for a limited period, to permit them to demonstrate that they are in compliance with the new standards?

Without knowing what changes will ultimately be implemented, it is difficult to know whether existing REPs should be grandfathered entirely from one or more of new requirements, or how much time would be reasonably required to allow REPs to come into compliance. Assuming that existing REPs will be subject to new more stringent requirements, TXU Energy asks that REPs be permitted a reasonable period of time to demonstrate compliance.

III. PRAYER

WHEREFORE, PREMISES CONSIDERED, TXU Energy Retail Company LLC respectfully requests that the Commission consider these comments and incorporate them in a proposed rule.

Respectfully submitted,

By: ______________________________

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