

**To:** Steve Scialabba  
**From:** Marc D. Montalvo  
**Date:** April 14, 2017  
**Subject:** Financial Surety Development Process Summary

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On October 3, 2016, the RI DPUC contacted Daymark Energy Advisors (“Daymark”) seeking support and advice to develop financial surety requirements pursuant to legislation in RI requiring that the DPUC propose such requirements for competitive retail providers. At that time retail suppliers needed pay only a \$100 registration fee to be able to participate in the RI retail market. Daymark reviewed the requirements and intent of the legislation and based on experience developing credit requirements and surety rules for the wholesale market and on a review of approaches adopted in other jurisdictions, prepared a recommendation for the RI DPUC.

#### **Interactions with RI DPUC Staff**

Daymark provided an initial round of suggestions on October 14, 2016 outlining our observations of the market requirements elsewhere and draft language for discussion. That discussion took place on October 26, 2016. The RI DPUC took the issues identified and discussed under advisement.

On December 6, 2016, the RI DPUC contacted Daymark with a specific request to review a rough draft of a potential regulation and to provide comments and input to address the issues raised during the October discussions. In addition, RI DPUC requested assessment and support for the recommended \$250,000 flat surety requirement. Daymark provided its input on December 29, 2016.

There were periodic phone conversations to discuss issues and follow up emails exchanged during this period.

#### **Materials Reviewed**

The RI DPUC provided the following materials for Daymark’s review as part of this effort.

- House Bill 331 Security Deposit NPPs
- Title 381, Division of Public Utilities and Carriers, Rhode Island Code of State Regulations, Chapter 40 Electric Utilities, Sub-Chapter 05 Nonregulated Power Producers, Part 1 Rules Applicable to Nonregulated Power Producers (NPPs) – 1<sup>st</sup> draft 31 October 2016 modifications (note this was reviewed pre and post such proposed modifications)

- Rhode Island Renewable Energy Standard, Annual RES Compliance Report For Compliance Year 2014, April 2016
- STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS, DIVISION OF PUBLIC UTILITIES AND CARRIERS, RULES APPLICABLE TO NONREGULATED POWER PRODUCER, Effective Date: January 1, 2015
- STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS, PUBLIC UTILITIES COMMISSION, CONSUMER PROTECTION REQUIREMENTS FOR NONREGULATED POWER PRODUCERS, Effective Date: October 20, 2014

Daymark Energy Advisors also reviewed the following.

- Application for License to Supply Electricity or Electric Generation Services to the Public in the State of Maryland
- PENNSYLVANIA PUBLIC UTILITY COMMISSION, Bonding Requirements for Electric Generation Suppliers; Acceptable Security Instruments; [43 Pa.B. 7521]; Saturday, December 21, 2013
- PUBLIC UTILITY COMMISSION OF TEXAS STANDARD GUARANTY AGREEMENT FOR RETAIL ELECTRIC PROVIDERS
- Sample IRREVOCABLE STANDBY LETTER OF CREDIT – TX
- PUBLIC UTILITY COMMISSION OF TEXAS SUBSTANTIVE RULES. CHAPTER 25. ELECTRIC. §25.107 establishes requirements for certification of retail electric providers (REPs), application procedures, requirements for maintaining certificates, and provisions for suspension and revocation of certificates, as well as related administrative penalties.

In addition to these documents, Daymark reviewed several other state's retail supplier surety requirements.

## Recommendations

Daymark provided the RI DPUC the following initial recommendation for discussion on October 14, 2016:

### Suggested Language for the Surety Rule for NPPs:

Nonregulated power producers, who may be obligated entities under §39-26-2(16), shall provide security such as a surety bond or other financial instrument showing evidence of liquid funds, such as a certificate of deposit, an irrevocable letter of credit from an ISO New England Eligible Letter of Credit Bank, a line of credit, a loan or guarantee, of not less than \$250,000 and not more than \$500,000 according to the level of annual retail sales, as shown below.

Surety	Annual Sales (MWh)
\$500,000	Over 100,000
\$250,000	Up to 100,000

The financial instrument shall name the public utilities commission and division of public utilities and carriers as obligees. The financial security shall be available to satisfy penalties assessed by the division for violations of any consumer protection rules or laws related to nonregulated power producers, refunds ordered by the division, failure to comply with Rhode Island's Renewable Energy Standard (RES), or failure to comply with other provisions of chapter 26 of title 39, as determined by the public utilities commission. Financial security shall be reviewed each year at the time a nonregulated power producer makes its annual filing.

NOTE: Agreements that bind the collateral will have to be drafted and executed by the parties. Control agreements that allow for the release of collateral in fulfillment of obligations at the state's instruction are also needed. We recommend that the need and general form of such agreements be established in the regulation, but not put the agreements in the regulation, so that they can be changed administratively as needed.

#### Discussion of Initial Recommendation

Other states requiring surety (MD, TX, PA, NJ) are set at \$250,000 for all Competitive Electricity Supplier (CES), regardless of the size of their retail sales in that market. The state of Connecticut requires \$250,000 or five per cent of its estimated gross receipts which is revisited every year and adjusted as needed. Delaware requires surety of 150% of the deposits, advance payments, prepayments, financial guarantees or the like from a CES' customers, or \$50,000, and requires demonstration of liquid assets of \$100,000 in order to be certified.

The intent of the surety proposed here is to act as a deterrent to CES' defaulting on the RES requirements, and providing a source of payment for any other penalties imposed by the Commission, if needed.

There were 21 CES that submitted annual reports in 2014 (latest report available) and their average annual sales were 127,053 MWh. If one CES completely defaults on its RES requirements in 2016, assuming similar retail sales levels as 2014 and an RES requirement of 10%, the Alternative Compliance Payment (ACP) to cover its RES would be \$851,255.

We recommend a two-step surety to reflect the risk of meeting RES in any given year is greater for larger CES', though one can see that the surety may not cover a full default. The smaller CES will have the same level of surety as is currently imposed in other states.

### **Approach Adopted**

After discussion with the RI DPUC staff in October and early December 2016, Daymark agreed to revise the proposal to establish a single surety requirement. This change recognized that the entities at greatest risk of default were smaller players that tended to have low capitalization. For example, Global's default resulted in an uncovered exposure of approximately \$280,000. A single surety requirement of the order of \$250,000 would be consistent with other states, roughly consistent with the experienced order or magnitude of default, and ease of oversight and administration.

### **NPP Surety Rule Language Drafted and Submitted December 29, 2016**

Based on RI DPUC's chosen approach, Daymark refined the proposed language of the regulation (see below) and provided a draft sample surety agreement.

#### *Proposed Regulation*

9. Evidence of financial soundness such as surety bonds, a recent financial statement, or other mechanism as specified by the Division, except those nonregulated power producers who may be obligated entities shall provide financial security such as: a surety bond, a certificate of deposit, an irrevocable standby letter of credit from a New York Mercantile Exchange ("NYMEX") or Chicago Mercantile Exchange ("CME") approved letter of credit bank, , or a corporate guarantee from an investment-grade entity with a Tangible Net Worth of at least \$10 million. The financial security shall be in an amount of not less than \$250,000.00. All financial security provided in satisfaction of this provision shall name the Commission and Division as obligees.

Financial security shall be reviewed each year at the time a nonregulated power producer makes its annual filing. The above notwithstanding, each obligated entity is responsible for informing the Division in writing within five (5) business days of any material adverse change in its financial status. The financial security shall be available to satisfy penalties assessed by the Division for violations of any consumer protection rules or laws related to nonregulated power producers, refunds ordered by the Division, or failure to comply with the provisions of Chapter 26, Title 39, Rhode Island General Laws

as determined by the Public Utilities Commission. Payments made pursuant to this subsection for violation of the provisions of R.I.G.L. § 39-26-7, or any successor funds, and all other forfeitures will be remitted to the state's general fund.

In the section covering Rescission of the NPP's Registration, we proposed to address how long the Commission or Division may require retention of the financial instrument.

Add new:

D. Financial security shall remain in place for the greater of six months or the discharge of all obligations following the final date of rescission subject to Commission receipt and investigation of complaints that may be filed.

Recommended Implementing documents – These may not need to be referenced in the language above but could be referenced in paragraph 9 as follows:

“All financial security provided in satisfaction of this provision shall name the Commission and Division as obliges and shall meet the language and form requirements of the Commission and Division as such direction is provided from time to time. “

- Security Agreement – perfects the collateral (required ... see an example below)
- Sample Corporate Guarantee (not necessary to provide a form, but if there is a standard, it simplifies review)
- Sample Standby Letter of Credit (not necessary to provide a form, but if there is a standard, it simplifies review)

**EXAMPLE SECURITY AGREEMENT**

THIS SECURITY AGREEMENT (the “Security Agreement”) is effective as of this [\_\_] day of [\_\_\_\_], 20[\_\_\_], by and between [INSERT NAME], a [\_\_\_\_], having its principal office and place of business at [\_\_\_\_] (the “Debtor”), and the Rhode Island Public Utilities Commission and the Rhode Island Department of Utilities and Carriers.

**WITNESSETH:**

In consideration of the mutual promises and covenants herein contained, the Parties agree as follows:

**1. Definitions.****a. In this Security Agreement:**

- i. “Code” shall mean the Uniform Commercial Code, as enacted in the State of Rhode Island and as amended from time to time.
- ii. “Collateral” shall mean (a) all cash provided, submitted, wired or otherwise transferred or deposited by the Debtor to or with the Secured Party or a financial institution, investment firm, or other designee selected by the Secured Party or acting on the Secured Party’s behalf, to hold or invest such cash deposit, from time to time in satisfaction of, pursuant to, or in compliance with, Financial Security Requirements; (b) all securities or other investment property (as defined in the Code) of the Debtor, whether or not purchased with such cash deposit, submitted, wired or otherwise transferred, deposited or maintained by the Debtor to or with the Secured Party or its designee, in each case in satisfaction of, pursuant to, or in compliance with, Financial Security Requirements; (c) all other property of Debtor submitted, pledged, assigned or otherwise transferred by the Debtor to the Secured Party or its designee, in each case, in satisfaction of, pursuant to, or in compliance with, Financial Security Requirements; and (d) the products and proceeds of each of the foregoing.
- iii. “Financial Security Requirements” shall mean the provisions of 381-RICR-40-05-1.2.A.9
- iv. “Obligations” shall mean any and all amounts due from Debtor from time to time under the RI Code of State Regulation.
- v. “Obligated Entity” shall have the meaning set forth in the RI Code of State Regulation.

b. Any capitalized term not defined herein that is defined in the Code shall have the meaning as defined in the Code.

2. Security Interest. To secure the payment of all Obligations of the Debtor, Debtor hereby grants and conveys to the Secured Party a security interest in the Collateral. The Debtor hereby irrevocably authorizes the Secured Party at any time and from time to time to file in any applicable filing office any initial financing statements and amendments thereto that provide any information required by [insert reference to part and section of RI Code] for the sufficiency or filing office acceptance of any financing statement or amendment.

3. Debtor's Covenants. The Debtor warrants, covenants and agrees with the Secured Party as follows:

a. The Debtor shall perform all of the Debtor's obligations under this Security Agreement according to its terms.

b. The Debtor shall defend the title to the Collateral against any and all persons and against all claims.

c. The Debtor shall at any time and from time to time take such steps as the Secured Party may reasonably request to ensure the continued perfection and priority of the Secured Party's security interest in the Collateral and the preservation of its rights therein.

d. The Debtor acknowledges and agrees that this Security Agreement grants, and is intended to grant, a security interest in the Collateral. If the Debtor is a corporation, limited liability company, limited partnership or other Registered Organization as defined in the Code the

Debtor shall, at its expense, furnish to Secured Party a certified copy of Debtor's organization documents verifying its correct legal name or, at Secured Party's election, shall permit the Secured Party to obtain such certified copy at Debtor's expense. From time to time at Secured Party's election, the Secured Party may obtain a certified copy of Debtor's organization documents and a search of such Uniform Commercial Code filing offices, as it shall deem appropriate, at Debtor's expense, to verify Debtor's compliance with the terms of this Security Agreement.

e. The Debtor authorizes the Secured Party, if the Debtor fails to do so, to do all things required of the Debtor herein and charge all expenses incurred by the Secured Party to the Debtor together with interest thereon, which expenses and interest will be added to the Obligations.

4. Debtor's Representations and Warranties. The Debtor represents and warrants to the Secured Party as follows:

a. The exact legal name of the Debtor is as first stated above.

b. Except for the security interest of the Secured Party, Debtor is the owner of the Collateral free and clear of any encumbrance of any nature.

5. Non-Waiver. Waiver of or acquiescence in any default by the Debtor or failure of the Secured Party to insist upon strict performance by the Debtor of any warranties, covenants, or agreements in this Security Agreement shall not constitute a waiver of any subsequent or other default or failure. No failure to exercise or delay in exercising any right, power or remedy of the Secured Party under this Security Agreement shall operate as a waiver thereof, nor shall any partial exercise of any right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy. The failure of the Secured Party to insist upon the strict observance or performance of any provision of this Security Agreement shall not be construed as a waiver or relinquishment of such provision. The rights and remedies provided herein are cumulative and not exclusive of any other rights or remedies provided at law or in equity.

6. Events of Default. Any one of the following shall constitute an “Event of Default” hereunder by the Debtor:

- a. Failure by the Debtor to comply with or perform any provision of this Security Agreement or to pay any Obligation; or
- b. Any representation or warranty made or given by the Debtor in connection with this Security Agreement proves to be false or misleading in any material respect; or
- c. Any part of the Collateral is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes within the possession of any receiver, trustee, custodian or assignee for the benefit of creditors.

7. Remedy upon the Occurrence of an Event of Default. Upon the occurrence of any Event of Default the Secured Party shall, immediately and without notice, be entitled to use, sell, or otherwise liquidate the Collateral to pay all Obligations owed by the Debtor.

8. Attorneys’ Fees, etc. Upon the occurrence of any Event of Default, the Secured Party’s reasonable attorneys’ fees and the legal and other expenses for pursuing, receiving, taking, keeping, selling, and liquidating the Collateral and enforcing the Security Agreement shall be chargeable to the Debtor.

9. Other Rights.

- a. In addition to all rights and remedies herein and otherwise available at law or in equity, upon the occurrence of an Event of Default, the Secured Party shall have such other rights and remedies as are set forth in the RI Code of State Regulation and Financial Security Requirements.



b. Debtor hereby (i) authorizes the Secured Party to disclose any information concerning Debtor to any court, agency or entity which is necessary or desirable, in the sole discretion of the Secured Party, to establish, maintain, perfect or secure the Secured Party's rights and interest in the Collateral (the "Debtor Information"); and (ii) waives any rights it may have under to prevent, impair or limit the Secured Party from disclosing such information concerning the Debtor.

10. PRE-JUDGMENT REMEDY. DEBTOR ACKNOWLEDGES THAT THIS SECURITY AGREEMENT AND THE UNDERLYING TRANSACTIONS GIVING RISE HERETO CONSTITUTE COMMERCIAL BUSINESS TRANSACTED WITHIN THE STATE OF RHODE ISLAND. IN THE EVENT OF ANY LEGAL ACTION BETWEEN DEBTOR AND THE SECURED PARTY HEREUNDER, DEBTOR HEREBY EXPRESSLY WAIVES ANY RIGHTS WITH REGARD TO NOTICE, PRIOR HEARING AND ANY OTHER RIGHTS IT MAY HAVE UNDER THE RHODE ISLAND GENERAL STATUTES, CHAPTER ###, AS NOW CONSTITUTED OR HEREAFTER AMENDED, OR OTHER STATUTE OR STATUTES, STATE OR FEDERAL, AFFECTING PREJUDGMENT REMEDIES, AND THE SECURED PARTY MAY INVOKE ANY PREJUDGMENT REMEDY AVAILABLE TO IT, INCLUDING, BUT NOT LIMITED TO, GARNISHMENT, ATTACHMENT, FOREIGN ATTACHMENT AND REPLEVIN, WITH RESPECT TO ANY TANGIBLE OR INTANGIBLE PROPERTY (WHETHER REAL OR PERSONAL) OF DEBTOR TO ENFORCE THE PROVISIONS OF THIS SECURITY AGREEMENT, WITHOUT GIVING DEBTOR ANY NOTICE OR OPPORTUNITY FOR A HEARING.

11. WAIVER OF JURY TRIAL. THE DEBTOR AND THE SECURED PARTY HEREBY EACH KNOWINGLY, VOLUNTARILY AND IRREVOCABLY WAIVES THE RIGHT TO TRIAL BY JURY IN ANY ACTION, DEFENSE, COUNTERCLAIM, CROSSCLAIM AND/OR ANY FORM OF PROCEEDING BROUGHT IN RHODE ISLAND WITH THIS SECURITY AGREEMENT OR RELATING TO ANY OBLIGATIONS SECURED HEREBY.

12. Additional Waivers. Demand, presentment, protest and notice of nonpayment are hereby waived by Debtor. Debtor also waives the benefit of all valuation, appraisal and exemption laws.

13. Binding Effect. The terms, warranties and agreements herein contained shall bind and inure to the benefit of the respective Parties hereto, and their respective legal representatives, successors and assigns.

14. Assignment. The Secured Party may, upon notice to the Debtor, assign without limitation its security interest in the Collateral.

15. Amendment. This Security Agreement may not be altered or amended except by an agreement in writing signed by the Parties.

16. Term.

a. This Security Agreement shall continue in full force and effect until all Obligations owed by the Debtor have been paid in full.

b. No termination of this Security Agreement shall in any way affect or impair the rights and liabilities of the Parties hereto relating to any transaction or events prior to such termination date, or to the Collateral in which the Secured Party has a security interest, and all agreements, warranties and representations of the Debtor shall survive such termination.

17. Choice of Law. The laws of the State of Rhode Island shall govern the rights and duties of the Parties herein contained without giving effect to any conflict-of-law principles.

IN WITNESS WHEREOF, the Parties have signed and sealed this Security Agreement as of the day and year first above written.

[INSERT NAME]

By: \_\_\_\_\_

Name:

Title:

RI PUC

By: \_\_\_\_\_

Name:

Title: