



## *Series of Regulatory Choices*

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# **Regulatory Issues and Questions Presented by Voluntary Prepay Options Offered by Utilities**

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*DEFG's Series of Regulatory Choices explores the federal, state and local regulatory decisions that expand the choices available to energy consumers as they construct and inhabit buildings, purchase and maintain energy-consuming devices, purchase energy, or manage their consumption of energy. Greater choice increases efficiency.*

**◀ All agencies make a series of choices ▶**

## Executive Summary

The development of customer-facing applications of smart grid invites the question: How do existing regulatory constructs comport with technological innovation? At first glance, prepaying for energy may appear to be just another payment channel for consumers, where energy is purchased now for consumption later. When supported by smart technologies, prepay may be linked with a two-way communication channel between the supplier and consumer. Energy consumption data is made available to suppliers in regular intervals (fifteen-minute, hourly, daily, etc.), which allows for different types of pricing structures. Consumers may also opt to receive communications regarding payment and account updates, price signals (potentially using dynamic pricing), and energy management options. Prepay enabled by smart grid is thus a billing option with a consistent feedback loop delivered via SMS, email, web-based portal, in-home display, or perhaps a combination of these options. The information flow allows consumers to monitor their usage, creating opportunities to reduce energy consumption and costs. With prepay, moreover, the usage data is tied to the payment transaction in real time, so consumers can directly relate energy consumption with dollars.

With the combination of grid infrastructure, smart technologies and regulatory policies in play however, there is not a one-size-fits-all approach to a utility prepay offering. These elements vary between jurisdictions creating challenges, with the regulatory hurdles being the biggest obstacle to introducing prepay in regulated markets. Prepay raises legitimate concerns around consumer protections, and exposes tensions and incompatibilities between existing regulatory constructs and new technological capabilities. Extensive research conducted by DEFG in 2010 revealed that prepay could be transformational as it touches on many of the more challenging regulatory questions facing the energy sector today and thus invites a far-reaching discussion around potential solutions.

## Introduction

A convergence of factors suggests that now may be the opportune time for prepay energy offerings. Economic realities driven by the recession created a real consumer need or preference for increased budget management, while consumer expectations for more choice around payment options and personalized experiences have sharpened. Consumer awareness and adoption of different prepay options have seen a dramatic increase over the last few years around products and services such as reloadable debit cards, gift cards, wireless service, public transit cards and toll programs (e.g., EZPass). Existing prepay programs have demonstrated, moreover, that the anticipated benefits of prepay – increased customer satisfaction, reduced energy consumption and reduced delinquency costs – can indeed be realized.

Benefits in support of a prepay business case need to be balanced against a number of regulatory challenges. The critical policy areas touched by prepay appear to be, in priority, as follows: 1) service disconnect, moratoriums, and notification; 2) specific concerns for low-income and high-risk customers; 3) cost allocation, recovery, and treatment; 4) tariff; and 5) billing & accounting. Concerns around consumer protections moreover cut across each of these policy areas.

This paper will frame and discuss the regulatory issues tied to prepay, and present the perspectives and different points of view of state utility regulators and consumer advocates. It is helpful to identify a basis for the questions, challenges and concerns presented in order to frame the regulatory issues. For example, to inquire whether a fundamental value is involved (e.g., everyone must be served equally) or a consideration involving a life or death situation (e.g., dependency on an electronic medical device). Additionally, a rule formulated decades ago might be based on older technologies, and with new capabilities there would be the potential for change. Or, perhaps a rule or practice is rooted in a philosophy (e.g., supporting or opposing the role of competition in energy markets).

The objective of this paper is not to provide solutions. Here, DEFG only intends to identify and prioritize stakeholder positions around the leading regulatory issues facing prepay. This paper will serve as a framework for further investigation led by a DEFG-sponsored Utility Prepay Working Group in 2011. (See Next Steps for 2011, at p. 7.)

# Regulatory Issues Presented by Prepay Energy Offerings

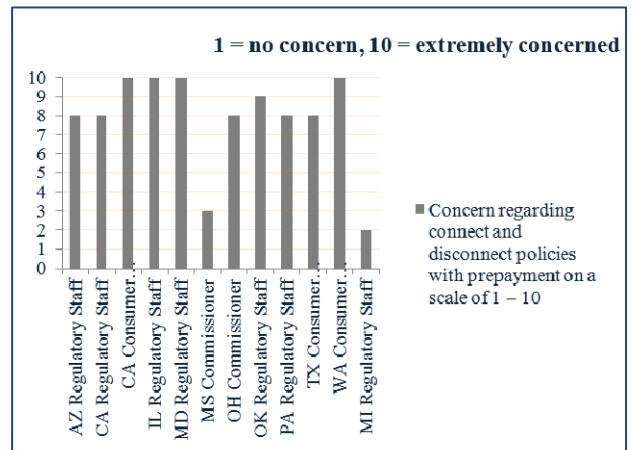
## Background

DEFG convened an advisory panel of energy industry thought leaders with the purpose of identifying the leading regulatory issues facing prepay, and then invited discussion around these key issues through an interview process involving nine regulators and three advocates representing the following states: Arizona, California (2), Illinois, Maryland, Michigan, Mississippi, Ohio, Oklahoma, Pennsylvania, Texas and Washington. Additionally, DEFG conducted an industry survey on prepay, garnering 600+ responses representing a broad array of industry views, with nearly all of the respondents highlighting regulatory issues from some angle.<sup>1</sup>

## Service Disconnect, Moratoriums & Notification

Disconnect and related consumer protection policies were by far the leading concern among both interview and survey respondents.<sup>2</sup> While disconnect, moratoriums and notification are distinct regulatory areas, there is significant overlap when dealing with prepay. Specific questions and concerns included:

- Could disconnection happen any time of the day/week?
- What is the time lag around disconnect/reconnect?
- Would prepay customers be afforded the same types of protection provided to post-pay customers?
- Does prepay require greater or different consumer protections?
- What role does electronic communication play in providing disconnection notices and account status alerts?
- Do existing moratoriums apply to prepay customers?



## Different Perspectives

Certain respondents found prepay incompatible with their states' existing notice requirements for service termination<sup>3</sup> as current rules call for either written or in-person notice. With the array of new electronic capabilities available today (robo-dial, SMS, email, and various in-home portals), existing rules requiring a visit to a customer's home or notice via the U.S. Postal Service to warn of imminent service termination can arguably be viewed as vestiges from an earlier era. Most regulators acknowledge that e-communication has become an acceptable and even a preferred method of communication for some customers, and further generally believe it is possible to amend existing notice and disconnect policies to cover e-communication. There is however a strong emphasis on maintaining the strength of consumer protections around notice requirements, so any changes would probably at minimum need to afford prepay customers similar protections as post-pay customers. With the relative ease of e-communication, moreover, regulators assert that more frequent updates and notices from utilities would likely be required, and that these regular notices would also need to be delivered via customer-preferred channels identified at the outset, which might mean several forms of communication (i.e., via SMS, email and robo-dial/out-bound automated calls).

<sup>1</sup> The survey included regulatory-specific issues, so where appropriate any relevant questions raised or findings will be referenced. Respondents self-identified (as percentage of sample): consultants (19%), regulators/government (11%), utilities (20%), public interest/consumer representatives (14%), and marketers/retail energy (9%).

<sup>2</sup> Out of 240+ industry survey responses to the question, "What regulatory questions around prepay do you feel need to be answered?" the most common concern involved disconnection procedures.

<sup>3</sup> I.e., Arizona, Maryland, Mississippi, Pennsylvania.

Additional questions focus on consumer protections around disconnect and reconnect, such as how much time is allowed to make a payment prior to disconnect, could disconnect happen during nights and weekends, and what would be the maximum time lag between payment and reconnect. Most regulators believe existing disconnect and notice rules can be re-worked to adequately protect prepay customer. Exempting voluntary prepay from existing notice and disconnect rules was noted as an alternate course, which depending on the jurisdiction might require an amendment through the rulemaking process.

The consumer advocate from Washington holds that equitable access to energy is a right and access to energy is a necessity – that there is a societal responsibility to make sure access is provided in a manner as fully as possible without reducing a person or group to the category of a second-class citizen or second-class service. When denied access to energy, the Washington advocate posits that there is a harm suffered and thus service disconnection due to the failure to make a prepayment is indeed a violation of consumer protection laws. Likewise, the advocate from California voiced “deep philosophical problems with prepaid energy service,” not finding it to be a useful service when it results in service disconnection for failure to keep payments current.

Regulators and consumer advocates are in agreement that disconnect should not be permitted when loss of heating or air-conditioning might lead to serious illness or death. Prepay is currently in place in Texas and Ohio, and weather moratoriums (temperature and/or date-based) do apply to prepay customers in both states. The Texas advocate and Ohio commissioner interviewed by DEFG expressed the shared view that prepaid customers should be afforded the same protections as post-paid customers, a principle certainly in play when a life or death risk is present.

### *Specific Concerns for Low-Income and High-Risk Populations*

While the issues around disconnect, notice and moratoriums essentially mirror the discussion above, there are additional concerns specific to low-income and high-risk populations (elderly or dependent on medical devices). These concerns were voiced by nearly all interview and survey respondents, and included the following:

- Management of service disconnect, moratoriums and notification (issues noted above)
- Communication with non-English speakers
- Customer cash-flow challenges
- Options for topping up accounts (ease of options)
- Penalties/transaction fees for cash payments (“payday loan” environment)
- Compatibility with government energy assistance programs
- Inability to top up (elderly, disabled cannot leave home; no Internet access)
- Risks related to persons dependent on medical devices

### **Different Perspectives**

Respondents voiced concerns that low-income customers might not have consistent (24 hour, 7 days a week) access to either SMS or email to receive critical account alerts, and further that these alerts might not be in the language of non-English speakers. Additionally, there are concerns around cash-flow challenges, potentially resulting in customers not having the means to make payments, and thus being disconnected and without power for an extended period. A California consumer advocate posited that prepay invites customers to place a value on saving money versus reliability and a commitment to energy being available; those for whom money is dear will potentially make a trade off, devaluing the ubiquity of energy services and turning it into a commodity.

Concerns around “predatory” payment channels are an additional low-income specific issue. There is apprehension that prepay may create a sort of “payday loan” environment where low-income customers dependent on cash will need to buy energy in person, incurring additional transaction fees or penalties not charged to customers buying energy online. An alternate perspective is that any fees for cash transactions would likely be negligible in comparison to late fees and

disconnection penalties incurred by customers on traditional post-paid plans. These post-paid penalties potentially lead to sizeable debt over time, which can become insurmountable for some low-income customers.

Both interview and survey respondents inquired about compatibility, or lack thereof, between prepay and energy assistance programs. Texas retailers have seen some success with the technical aspects of integrating prepay and certain government assistance programs. While these developments may serve as a reference, results in Texas may be merely anecdotal at this early stage.

Measures such as friendly-credit periods (no disconnection during nights and weekends) and limiting amperage were discussed as potential ways to alleviate concerns around disconnection. Consumer advocates still did not deviate from their view that prepay violates consumer protections around disconnect. Most regulators conveyed that a friendly-credit period (“FCP”) would likely be required, as flexibility is essential in order for customers to avoid disconnect. The regulator from Pennsylvania felt the Commission might be open to mechanisms that alleviate disconnect concerns, but would be reluctant to permit disconnection as Pennsylvania’s mindset is that power must always be available. Prepay in Pennsylvania thus might only be offered in a hybrid form, meaning customers would fall back into post-paid mode should their prepaid credit hit zero. The regulator from Illinois added that a FCP still assumes there is a convenient way to purchase energy, which just may not be the case for cash-dependent customers who need to travel to a payment center to make an in-person payment prior to disconnection.

Limiting amperage was generally an attractive proposition to regulators, though with many questioning as to how the logistics would work. The regulator from Maryland explained that limiting amperage has a varied history with utilities, inviting both support and opposition, and while it is an interesting alternative, it still may not solve all problems associated with disconnect. Limiting amperage technology may possibly create an opportunity for customers dependent on medical devices to enroll in a prepay program by alleviating safety concerns. Such a development would probably require redefining what is considered “life-line” or “emergency” service. Without the guarantee of sufficient amperage to support medical devices, however, commissions would not support such high-risk customers participating in prepay. Similar to weather moratoriums, a life or death consideration is a non-starter for prepay. For instance, in Texas, consumer protections currently require that customers dependent on medical devices must waive their rights, but energy retailers have in essence self-regulated by electing to not provide prepay service to critical care customers. This policy is currently being examined as part of a comprehensive rulemaking around prepay underway in Texas.

**Balancing Friendly-Credit Period and Limiting Amps with Prepay Program Costs (MD Regulatory Staff)**

The more leeway around disconnect, the less likely the customer gets the price advantage of the credit risk. Probably the reason why British prepay is not at lower cost compared to other prepay programs. Perhaps to guarantee a lower rate, customers must agree to immediate shut off, but maybe these customers have a credit card linked so there is an automatic top up. Not sure there is a one-size fits all.

### *Cost Allocation, Recovery & Treatment*

The interview process incited a good deal of debate around how potential transaction fees for prepay would be handled with ideas ranging from baking fees into the total cost of the tariff to passing fees through to the individual prepay consumer on the occasion of each payment. Likewise, there was discussion around how benefits from a reduction in a utility’s bad debt might be managed, either by passing savings through to all customers or perhaps to only those customers enrolled in prepay. Indeed a number of thought-provoking issues were raised with regard to cost, risk and benefit management. Respondents identified a set of fundamental questions that need to be addressed:

- Whether the cost to institute a prepay program is covered by the “savings” from the program.
- Would a utility retain any savings?
- Would a utility pass savings on to customers, and would that include only prepay customers or the entire customer base?
- Would a utility “eat” program-related costs/transaction fees?
- Is it appropriate for a utility to require prepay customers to cover program-related costs or transaction fees?

- Is a shared-savings model between utility and consumers best?
- Is a shared-costs model between utility and consumers best?
- Could the utility simply pass through a service offered by a 3rd party?
- Would service reliability increase for customers who prepay for energy?
- How might prioritization for return to service from an unforced outage be managed?
- Do prepay customers not pay charges during an outage?
- What is the cost associated with the risk borne by customers acting as creditors to energy suppliers?
- Do customers earn savings by managing dynamic pricing? (What does this risk cost vs. fixed-rate pricing?)

## Different Perspectives

Cost allocation, recovery and treatment is a regulated versus unregulated policy area, with non-regulated energy suppliers having flexibility to manage costs, benefits, and pricing however they decide. Regarding regulated service, a Maryland regulator suggests that a prepay program really needs to include appropriate messaging with regard to savings by both the utility and customers, and warns against making the assumption that prepay transaction costs would automatically pass through to the prepay customer, particularly when prepay service is intended to minimize bad debts and lower costs for both utilities and customers. In fact, the consumer survey recently released by DEFG's marketing affiliate EcoAlign reported that customers identified both transparency and clarity as requirements for a utility prepay offering, signaling that some customers are skeptical about who benefits from the offering.

The Commissioner from Mississippi supports spreading any costs and benefits across all customers, and thus disagrees with a scenario where only prepay customers pay transaction fees or only prepay customers receive the benefits from reduced bad debt. The notion of spreading both costs and benefits to all customers may not, however, be a possibility in all jurisdictions. Pennsylvania's Commission, for instance, was noted for being rather "cost conscientious" and does not permit one class of customers to subsidize costs associated with another class of customers, so any prepay transaction fees would likely need to be covered by customers enrolled in prepay. With proof that prepay minimizes bad debt however, a benefit might then flow to prepay customers or all customers. The regulator from California moreover points out that utilities generally should be able to recover any costs from working with a third party. Thus, if fees are not simply rolled into the tariff, he finds no problem with prepay customers paying a fee as long as it is reasonable.

There were also a great deal of questions around management or shifting of risks, and how the cost associated with the risk borne by customers acting as creditors might be valued. A regulator suggested that prepay customers acting as creditors to utilities might deserve higher priority with regard to service restoration following an outage (where possible as not all utilities manage generation, transmission and delivery). There was further discussion around whether prepay customers could enroll in a dynamic pricing plan (versus a fixed pricing plan), thus taking on increased risk and earning some level of savings. Different approaches to cost allocation, recovery and treatment indeed reflect the varying philosophies held by the individual regulators and/or commissions, and are further shaped by the different players, infrastructure, policy and pricing in each jurisdiction.

## *Tariff*

Tariff is treated differently in competitive and non-competitive markets. Competitive markets may look to Texas for guidance as prepay is being offered by several retailers, though the programs are still in the early stages. In a regulated setting, stakeholders need to address a number of issues around tariff, many of which were raised by respondents but not fully explored. Respondents focused on the following inquiries and challenges in the regulated setting:

- Whether prepay is a rate or a rider
- Whether to view prepay as merely a billing mechanism
- Whether prepay might fit into a complex tiered tariff structure (i.e., California), or be treated as a separate tariff
- How to treat variable costs or surcharges including transaction fees, fuel adjustments, taxes, etc.
- Whether to follow existing pricing models used for post-pay customers

- Whether to use a strict cents per kWh or fixed rate, or with smart grid capabilities to offer dynamic pricing options
- Whether a peak-time rebate program could function alongside prepay

## Different Perspectives

There is a stripped down view of the prepay offering – that prepay is merely a billing option and not a rate, thus pricing structure should not be treated as a prepay-specific issue, but an advanced meter issue applicable to all billing options. Accordingly, any debate around the risks, challenges and benefits associated with customers managing increased information via a feedback loop and dynamic pricing, may be viewed as smart technology issues. With prepay supported by advanced technologies however, the discussion among both consumer advocates and regulators delved into concerns around the implications of pricing for prepay offerings.

Several regulators expressed caution around real-time pricing, seeing the model as potentially challenging and confusing for customers. An alternate view is that real-time pricing is a capability tied to smart grid and increased information management, and thus a means to empower customers with the data necessary to manage their usage and lower both energy consumption and costs. For instance, on a real-time pricing arrangement with pricing changing on an hourly basis, customers would receive hourly notices mirroring any changes. For certain stakeholders however, this scenario is problematic insofar as customers would see the volatility and struggle to predict and control costs.

In fact, the Commissioner from Ohio does not support a real-time project for prepay in the short-run, explaining that the model needs more of a track record, and furthermore, that any rate risk is converted to the customer. The Ohio Commissioner is however open to dynamic pricing and in fact a pilot with a critical peak timing structure where a rebate would be available to consumers who are efficient during designated peak/critical times has been approved. Likewise, a regulator from Arizona has not been advocating for real-time pricing, noting that with prepay in particular, should rates spike and customers not immediately react to manage their usage, the result might be depletion of credit and disconnection in an unexpectedly quick time frame. Shared concerns led nearly all respondents to emphasize the importance of a strong customer educational component and notification process along with any real-time pricing plan.

From the retail side, particularly in Texas, a fresh perspective on the relationship between energy providers and consumers has been proffered – the notion that the customer needs to earn credit. This transfers accountability from the provider to the customer. The Commissioner from Mississippi however points out that, with a prepay program, the consumer becomes the creditor by paying in advance and thus bears additional risk. Under such a system, he suggest there be greater attention paid to guaranteed service as well as a customer grievance process for those customers who pay in advance and do not receive service.

### *Billing & Accounting*

Smart grid enables new forms of two-way communication between suppliers and customers, which in turn leads to new options for billing and accounting. Customers can observe usage and account information, and control energy management options. These new capabilities directly link the transaction (i.e., purchasing energy) with energy consumption, and thus customers may have a difficult differentiating between smart grid capabilities and billing as they overlap and interact. For the customer, the feedback loop and electronic billing information will meld together. These new approaches to billing and account raise a new set of questions and challenges:

- Is prepay a behavioral type offering?
- Which consumer segments would be interested in prepay?
- What does the feedback loop itself accomplish without a prepayment contract or dynamic pricing?
- What percent of customers will refer to their usage information to meaningfully act on it? How persistent will that behavior be?

## Different Perspectives

Regulators expressed an increased interest in prepay in response to the possibility that prepay can result in some energy savings and efficiency through increased awareness by consumers of what is being consumed and what energy costs by way of information sent from their supplier via SMS, a web portal, in-home display, etc. The prospect that utilities may be able to tie prepay into their energy efficiency and conservation goals is generally appealing to regulators, though there is a strong need for evidence in support of this notion.

Consumer advocates did not acknowledge a direct link between prepay and energy savings and efficiency. The advocate from California held that feedback benefits are possible without the risk of quick disconnection, so to ascribe energy savings to the prepay element is inaccurate as the same savings would likely materialize if disconnection were not at risk. He further added that there is no problem with sending proper economic signals to customers who have the wherewithal to respond to those signals.

The regulator from Arizona on the one hand noted that prepay tied to smart grid capabilities may appeal to subsets of consumers, such as younger, technologically savvy consumers. Prepay may therefore fall into a behavioral-type offering. This view supports the notion that the voice of the customer may lead the utility to offer different options and services.

## Conclusion

With the rapid rollout of smart grid and advanced communication and information management capabilities, a groundswell of fresh thinking and openness to doing things differently is needed in the regulatory arena. Prepay touches on some of the most challenging regulatory questions currently facing the energy sector, and thus represents an opportunity to enter into far-reaching discussions on policies such as disconnection, updated consumer protections, tariff structure, billing, communications, energy conservation, and more.

To make room for new products and services that will lead to customer-facing benefits from the investment in smart grid, the utility sector needs to collectively find a way to move from a “ratepayer” approach to a “customer” mentality. This means a shift away from providing only the same service and treatment for all customers, to differentiated service for customers with diverse needs, preferences, and values. Prepay has potential to develop as a multi-faceted program, thus a customer-facing return on smart grid investments, an offering development, and a virtual choice for consumers. Should regulatory issues facing prepay not be dealt with in the near term, prepay and other product and service innovations enabled by smart grid could be delayed indefinitely, which depending on the audience may be a good or bad thing.

## Appendix A: Next Steps for 2011

Below are some initial regulatory “straw man” proposals for each policy area discussed above. These proposals were developed out of DEFG’s multi-client research initiative conducted in 2010. The proposals are meant only to encourage discussion and thus are not intended to be solutions. For 2011, DEFG has proposed the creation and management of a Utility Prepay Working Group to further investigate the following:

- Developing trends in prepay industries
- Ongoing investigation and collection of data connected to markets and pilots with prepay customers
- Consumer market research and surveys
- Operational issues around prepay implementation, and related consumer expectations and preferences
- Regulatory challenges and questions

Work on the regulatory issues would include an expansion of the Advisory Board created in 2010 to include more regulators, consumer advocates and selected stakeholders from other public interest groups to continue discussing and prioritizing the issues of concern, and have the goal of developing viable proposals for solving the regulatory issues facing prepay. A process for proposing potential solutions will be established, including the creation of a regulatory issues database to facilitate consensus-building and quicker adoption at the state level.

1. Disconnect, Moratoriums & Notification	2. Low-Income & Credit	3. Cost Allocation, Recovery & Treatment	4. Tariff	5. Billing & Accounting
<ul style="list-style-type: none"> <li>- Prepay alerts are part of increased feedback and account management options</li> <li>- Moratoriums apply to prepay customers</li> <li>- Do not offer to elderly or persons dependent on medical devices</li> <li>- Redefine what is life-line / emergency service to use limiting amperage</li> <li>- Require either a security deposit, credit card or linked bank account to cover float</li> <li>- Upon disconnect fall back on traditional service as default</li> </ul>	<ul style="list-style-type: none"> <li>- Make prepay compatible with energy assistance programs</li> <li>- Consistent (potentially daily) messaging via customers' preferred means of communication</li> <li>- Standard consumer protections hold for prepay</li> </ul>	<ul style="list-style-type: none"> <li>- Define mechanism; is prepay a rate case or a rider?</li> <li>- Utility keeps any savings</li> <li>- Utility eats any program-related costs and passes any savings onto the customer</li> <li>- Shared-savings model between utility and consumers</li> <li>- Energy conservation is treated as a savings factor</li> <li>- Utility is simply a pass through; service is offered by a 3<sup>rd</sup> party</li> </ul>	<ul style="list-style-type: none"> <li>- "All-in" option without future adjustment (covers fuel adjustment, taxes, fees, etc.)</li> <li>- Competitive states look at TX model</li> <li>- Regulated states look to Salt River Project as a model</li> <li>- For pilot programs, seek waiver as a temporary measure</li> <li>- Consider prepay from a fresh perspective - where the customer needs to earn credit</li> </ul>	<ul style="list-style-type: none"> <li>- Break tie with paper billing</li> <li>- Shared savings for going paperless</li> <li>- Tie into energy conservation and goals</li> <li>- Hybrid offering with traditional plan as back-up system satisfies requirement for monthly bill</li> </ul>

## Appendix B

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