McGUIREWOODS — **MEMORANDUM**

TO: Bill Boswell, NAESB Managing Committee,
Rae McQuade

FROM: Jay Costan

CC: Jim Buccigross

DATE: March 6, 2003

RE: Guidance to Executive Committee on Further Consideration of Creditworthiness Standards

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This memorandum will set forth guidelines to help the Managing Committee in developing instructions to be communicated by the NAESB Board to the Executive Committee of the Wholesale Gas Quadrant to assist in the development of standards on creditworthiness, as requested by the Federal Energy Regulatory Commission ("FERC") in mid-September 2002.

I. <u>Background</u>

In September 2002, the FERC issued suspension orders in two cases involving proposed creditworthiness standards to be included in interstate pipelines' tariffs. *Tennessee Gas Pipeline Co.*, 100 FERC ¶ 61,268 (2002); *Northern Natural Gas Co.*, 100 FERC ¶ 61,278 (2002). In both cases, the FERC recognized the value of generic standards on creditworthiness and urged the parties:

> to initiate the standards development process at the North American Energy Standards Board (NAESB) to see whether a consensus standard can be developed for creditworthiness. By June 1, 2003, NAESB, and other parties, should file a report with the Commission indicating whether standards have been adopted, or if consensus cannot be reached, an account of its deliberations, including an outline of the standards considered, the voting records, and the reasons for the inability to reach consensus, to enable the Commission to determine whether further action is necessary.

Tennessee, 100 FERC ¶ 61,268 at P. 16.

Subsequent to the FERC's orders, the Board of Directors of NAESB directed the Executive Committee of the Wholesale Gas Quadrant to consider standards for creditworthiness, with the specific instruction that "such development should be restricted to implementation of existing Commission policy, new Commission policy after it has been ordered and non-policy oriented aspects of Creditworthiness." (Resolution adopted at September 23, 2002 NAESB Board Meeting.) This resolution was intended to incorporate the principle in Article 2, Section 2.2(b) of NAESB's Bylaws that the "Committees . . . of NAESB should endeavor not to create policy in their standards . . . development activities absent being requested to do so by the Board."

Subsequent to the September 23 NAESB Board Meeting, the WGQ EC commenced work on developing standards for creditworthiness, which provoked additional discussion regarding drawing the distinction between business practices and policy within the meaning of the NAESB Bylaws. In response to a report at the November 21, 2002 Board meeting, the Board again reiterated its desire that the EC confine its standards development to policies developed by the FERC or non-policy oriented aspects of creditworthiness.

In its February 20, 2003 meeting, the Wholesale Gas EC again visited the issue of standards development on creditworthiness, but reached an impasse because of the discomfort of certain members with even discussing policy-oriented aspects of creditworthiness standards. The discussion below will attempt to provide the Managing Committee and, ultimately, the EC with guidance on the transaction of business in EC meetings in instances where the EC has been directed by the Board to base standards on policy established by the FERC.

II. <u>Discussion</u>

The fact that the Board has directed the EC to develop standards based on "implementation of existing Commission policy, new Commission policy after it has been ordered and non-policy oriented aspects of creditworthiness," does not restrict or prevent the EC from discussing the policy-oriented aspects of creditworthiness. Indeed, such discussion may be necessary in order to reach a consensus to differentiate "policy" issues from non-policy issues. In addition, based on the instructions from the Board, the EC must differentiate between policies already established by the FERC and those that have not yet been established. In an effort to respond to the FERC's request of September 2002 to develop standards on creditworthiness, the NAESB Board has asked the EC to develop standards that will implement existing Commission policy on creditworthiness or new Commission policy after it has been ordered. Thus, provided it can reach consensus, the EC is expected to develop standards on creditworthiness, based on policies reflected in Commission orders on creditworthiness issued up through the time of the last WGQ EC meeting prior to June 1, 2003, when NAESB has been asked to submit a report to the FERC.

This is not to say that the EC's assignment is easy and clear cut. Based only on the mid-September 2002 orders of the FERC, it was admittedly difficult to determine what, if any, creditworthiness standards could be developed, because the FERC had left unaddressed many of the policy issues raised in the pipeline filings. Since mid-September, however, the Commission has issued subsequent orders in each of the cases that flesh out some of the policy issues and establish specific rules that pipelines must follow regarding creditworthiness provisions in their tariffs.[1] For example, in both the *Tennessee* and *Northern Natural* cases, the Commission has held that a pipeline may not require a shipper that loses its creditworthiness to post collateral equivalent to three months of charges within five business days after the shipper loses its creditworthiness. Instead, the pipeline must follow a two-step process: (i) it may require the shipper to post security sufficient to cover 30 days of expected charges within five business days of the time that the shipper loses its creditworthiness; and (ii) it may require the shipper to post collateral to secure three months of charges within 30 days after the shipper loses its creditworthiness.[2] *Tennessee*, 102 FERC ¶ 61,075 at P. 18 (2003); *Northern Natural*, 102 FERC ¶ 61,076 at PP. 48-49 (2003). The actions taken by the Commission in the *Tennessee* and *Northern Natural* cases in late 2002 and in January 2003 should help clarify some of the Commission's policy on creditworthiness. In accordance with FERC regulations, these orders are binding and legally effective and represent FERC policy, notwithstanding that various parties have requested rehearing. *See* 18 C.F.R. § 385.713(e) (a request for rehearing does not stay the Commission's final orders).

An open discussion of creditworthiness at the WGQ EC meetings will be important to further progress in the standards development effort. Such a discussion may include discourse about policy aspects of creditworthiness. **Such discussions are not forbidden by the NAESB Bylaws or by the resolutions adopted by the Board instructing the EC to take up creditworthiness standards in an effort to respond to the FERC's request.** The emphasis of the Board resolutions is that the *final work product* of the EC reflect standards or business practices that implement "existing Commission policy, new Commission policy after it has been ordered and non-policy oriented aspects of Creditworthiness." The Board did not mean to cut off useful discussion that would be helpful in developing such final work product and in responding to the FERC's request.

One of the specific items that NAESB has been asked to address in recent FERC orders in the *Tennessee* and *Northern Natural* cases is the amount of time that a shipper who loses creditworthiness should be allowed to post collateral to continue service on a pipeline. *Tennessee*, 102 FERC ¶ 61,075 at P. 20; *Northern Natural*, 102 FERC ¶ 61,075 at P. 51. The EC may ultimately determine that, without further guidance from the FERC, development of such a standard would involve a policy call, or it may simply not be able to reach a consensus on such a standard or it may be able to

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[1] The FERC expressly acknowledged that its rulings in the individual pipeline cases would help delineate its policy on creditworthiness, which NAESB could take into account in its consideration of standards. *Tennessee*, 101 FERC ¶ 61,311 at P. 12. The Commission stated that, for present purposes, it intends to enunciate its policy on creditworthiness through case-by-case determinations rather than a generic proceeding. *Id*. at P. 13.

[2] The foregoing rules assume that the shipper is not in default on any payments to the pipeline. If the shipper is in default under its transportation service agreement, the pipeline may exercise its right to suspend further service and take other steps to minimize its exposure to the defaulting shipper. *Tennessee*, 102 FERC ¶ 61,075 at P. 18.

respond fully to the FERC's request. In any case, whatever the EC does can be reported to the FERC on June 1, 2003.

To summarize, although the WGQ EC has been directed to develop standards on creditworthiness based on policy developed by the FERC or on non-policy considerations, the EC is not barred from discussing the policy aspects of creditworthiness standards in its meetings in an effort to reach a consensus on standards development. The EC's ultimate work product should conform to the direction from the Board that standards on creditworthiness should implement "existing Commission policy, new Commission policy after it has been ordered and non-policy oriented aspects of Creditworthiness." As part of its work, the EC should respond to the FERC's request for a report by June 1, 2003 on its progress in developing creditworthiness standards. Such report, which would initially be developed by the EC and then forwarded to the Managing Committee for ultimate transmittal to the FERC, should indicate "whether standards have been adopted, or if consensus cannot be reached, an account of NAESB's deliberations, including an outline of the standards considered, the voting records, and the reasons for the inability to reach consensus, to enable the Commission to determine whether further action is necessary." *Tennessee*, 101 FERC ¶ 61,311 at P. 4.