

## **COMMENTS OF THE PIPELINE SEGMENT ON PROPOSED CREDITWORTHINESS STANDARDS**

The Pipeline Segment, comprising all of the pipelines listed in Appendix A, hereby files its comments on the Creditworthiness Proposed Standards developed by the Wholesale Gas Quadrant's ("WGQ") Business Practices Subcommittee ("BPS").

### **A. SUMMARY OF POSITION**

On September 23, 2002, the NAESB Board of Directors adopted a resolution accepting the task of developing creditworthiness standards restricted to implementation of existing Commission policy, new Commission policy after it has been ordered and non-policy oriented aspects of creditworthiness. On October 17, 2002, the NAESB WGQ Executive Committee assigned the BPS the job of devising a work plan for developing such standards. Over the course of the next six months, the BPS developed a work plan and subsequently passed a total of 24 proposed standards.

During the course of the BPS discussions, it became apparent that the issue of whether a proposed standard would require NAESB to become involved in prohibited policy-making was often in the eye of the beholder, and was quite contentious. With some notable exceptions to be discussed below, the Pipeline Segment believes that the BPS is to be commended for focusing its efforts on both implementation and non-policy aspects of creditworthiness. As a result, the Pipeline Segment can support the overwhelming majority of the standards passed by a balanced vote of the five industry segments participating in the BPS process. As in any consensus building process, many of the standards that passed do not represent the preferences of any one segment,

including the pipelines. Indeed, the Pipeline Segment believes that with respect to many of the information and communication-related topics covered by the proposed standards, the current system is working quite well and there is no need to set more rigid requirements that may reduce pipelines' flexibility to address different circumstances and impose additional administrative costs on both pipelines and their shippers. However, the Pipeline Segment understands the desire on the part of certain segments of the industry for uniformity, and in an effort to accommodate the desires of the shippers that it serves, the Pipeline Segment can support the majority of these standards.

## **B. PROPOSED STANDARDS THE PIPELINE SEGMENT SUPPORTS**

The Pipeline Segment supports all of the standards passed by the BPS as they currently are worded, except for three to be more fully discussed below.<sup>1</sup> It should be kept in mind, however, that the standards supported by the pipelines represent hard-fought compromises, and any changes in language may cause the Pipeline Segment to withdraw its support. Before discussing the three standards that the Pipeline Segment opposes, the Pipeline Segment would like to expound on its support for two of the standards in particular: Proposed Standards 0.3.zO and 0.3.zL.

### **1. Proposed Standard 0.3.zO reads as follows:**

Except as to a Service Requester (SR) that subscribes to service in connection with construction, expansion, acquisition or lease of new facilities, the Transportation Service Provider's tariff should specify the amount of alternative credit assurance that will be required of a SR that is not creditworthy.

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<sup>1</sup> While Iroquois Gas Transmission System, L.P. ("Iroquois") agrees with the majority of the positions as presented in these comments, Iroquois does not agree with Proposed Standard 0.3.zJ unless a provision is added to that standard clarifying that a Service Requester submitting the public documents of its parent company should have a parental guarantee in place with the Transportation Service Provider.

This standard was one of the most hotly contested standards to be discussed at the BPS. Due to its importance, the Pipeline Segment wishes to explain the basis upon which it proposed and voted in favor of this standard. The standard distinguishes between the amount of credit assurance that is needed to support new facilities (whether constructed, acquired or leased), and the amount of credit that could be required in connection with service over existing facilities. The Commission has recognized that pipelines and their lenders bear substantially greater risk of cost recovery when undertaking new construction, and that greater credit requirements are appropriate. *See PG&E Gas Transmission, Northwest Corporation*, 103 FERC ¶ 61,137, slip op. at 10 (2003); *North Baja Pipeline, LLC*, 102 FERC ¶ 61,239, slip op. at 6 (2003). *See also Tennessee Gas Pipeline Company*, 102 FERC ¶ 61,075, slip op. at 16-17 (2003)(approving credit up to the cost of new facilities); *Natural Gas Pipeline Company of America*, 102 FERC ¶ 61,355, slip op. at 23-25 (2003)(same).

Under the Natural Gas Act, the decision as to whether to construct, expand, acquire or lease new facilities is within the pipeline's discretion in the first instance. Therefore, unless pipelines are permitted to ensure that adequate credit exists to support the expenditure of funds required to undertake a particular project, needed facilities will not be built. Moreover, pipelines must be free to tailor credit requirements to the characteristics of each particular project, its intended market and the current credit environment. Every project, and every market to be served by such project, is different. For example, a market comprised of proposed electric generators that do not themselves have contracts supporting their projects is considerably more speculative than a market of state-regulated local distribution companies that seek to serve core natural gas

requirements. Consequently, greater credit requirements may be needed from the former market to mitigate the inherent greater risk of non-recovery. Pipelines must be given the discretion to fashion credit requirements commensurate with the risks of the project. A uniform standard applicable to all pipelines and all projects is not appropriate.

As for the amount of credit that could be required for service over existing facilities, the Pipeline Segment believes that a standard that requires pipelines to specify such amount in its tariff is appropriate. The Pipeline Segment acknowledges that the Commission has in several recent cases stated that once a pipeline is in operation, a security requirement limited to three months of transportation charges is appropriate.

However, the Pipeline Segment does not believe that incorporating this three month limitation into a NAESB standard would be appropriate for several reasons. First, several of these recent orders are currently pending rehearing, and it would be premature for NAESB to preempt the Commission's consideration of these rehearing requests by setting a standard on the issue. Second, even if the Commission adopts the three month limitation as a matter of general policy, an individual pipeline should retain the ability to demonstrate that a level of credit assurance greater than three months of revenues is justified by lender requirements or experience with shipper defaults. An industry standard would foreclose this ability.

Third, there are several sub-issues related to this issue that would involve NAESB in prohibited policy-making. For instance, in some circumstances, it may not be clear whether Commission policy would view service as being requested over new or existing facilities. If a shipper seeks service on expansion facilities after the facilities are placed in service, it is not clear whether a three month or the higher credit requirement would

apply. Given the risk associated with the construction of new facilities, as recognized by the Commission, it would logically follow that pipelines should be permitted to require greater security for service on such facilities regardless of when the facilities are placed in service.<sup>2</sup> Otherwise, shippers desiring service on the new facilities could simply wait until the facilities go into service to take advantage of the lower credit requirement. This would make it harder for pipelines to obtain commitments needed to support construction, and would discourage pipelines from investing in needed infrastructure. Moreover, such a policy could result in two similarly situated shippers being subject to significantly different credit requirements.

Another example of undeveloped Commission policy that is integrally related to the amount of credit assurance that may be required involves the interrelationship of permanent capacity releases and credit requirements. Specifically, the recent Commission cases on creditworthiness have not addressed the issue of what credit requirements apply to replacement shippers that obtain capacity through a permanent release from a shipper that supported the construction of new facilities. Although a replacement shipper may seek service over such facilities after they have been placed in service, it would not be fair, nor good policy, for example, to require the pipeline to relinquish security up to the cost of the facilities in exchange for only three months of revenues.<sup>3</sup>

Given that Commission policy has not been fully developed on these issues, it is not appropriate for NAESB to attempt to determine what credit requirements apply to

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<sup>2</sup> Indeed, some pipelines may be subject to lender requirements that require more than three months of credit assurance in connection with new facilities regardless of when the shipper seeks service.

<sup>3</sup> This issue is discussed, *infra*, in connection with Proposed Standard 5.3.zE.

service over existing facilities. Until all issues relating to the distinction between existing and new facilities have been resolved by the Commission, such an attempt would necessarily and improperly involve NAESB in policy setting. A standard that provides that these matters will be determined by each TSP's tariff more appropriately allows the Commission, not NAESB, to develop policy.

2. Proposed Standard 0.3.zL reads as follows:

After a Transportation Service Provider's (TSP) receipt of a Service Requester's (SR) request for re-evaluation, including all required information pursuant to NAESB WGQ Standard [0.3.zK] ("SR's Request"), within [x] Business Days, the TSP should provide a written response to the SR's Request. Such written response should include either a determination of creditworthiness status, clearly stating the reason(s) for the TSP's decision, or an explanation supporting a future date by which a re-evaluation determination will be made. In no event should such re-evaluation determination exceed [y] Business Days from the date of the receipt of the SR's Request unless the parties mutually agree to some later date. The values for [x] and [y] should be specified in the TSP's tariff.

This standard sets time deadlines for a TSP's response to an SR's request for a re-evaluation of its credit status pursuant to Standard 0.3.zK. The intent of the provision is for the TSP to provide a preliminary response that includes either a credit determination, or an explanation of when such a determination can be expected, subject to an outside limit. The actual deadlines for both the preliminary response and final determination have not been set. Instead, the last sentence of the standard provides that these deadlines, represented by [x] and [y] values, should be specified in the TSP's tariff.

The Pipeline Segment's intent and understanding of this last sentence is that each TSP is free to set these deadlines in its tariff, subject to Commission approval. The Pipeline Segment does not view this sentence to be an agreement among the segments to request the Commission to set such deadlines for all pipelines. The Pipeline Segment does not believe that uniformity is required in this instance. Indeed, the time in which it

takes to respond to a re-evaluation request obviously will depend on the unique facts and complexity of each request, and the processing capability of each pipeline. While the Pipeline Segment is willing to agree to an outer limit if such a limit provides sufficient time to evaluate even the most complex request, the Pipeline Segment cannot support a deadline that does not provide the time required for an adequate evaluation. Given the potential ambiguity that exists as the standard is currently written, the Pipeline Segment suggests that the Executive Committee either (1) confirm the understanding and intent of all parties that TSP's are free to propose whatever deadlines they individually believe are appropriate for inclusion in their tariff; or (2) attempt to reach a consensus at May 20, 2003 Executive Committee meeting on the values of [x] and [y].

### **C. PROPOSED STANDARDS THE PIPELINE SEGMENT OPPOSES**

The Pipeline Segment opposes Proposed Standards 5.3.zE, 0.3.zN and 0.3.zP.

1. Proposed Standard 5.3.zE reads as follows:

The Transportation Service Provider (TSP) should allow an existing Service Requester (SR) to permanently release capacity to a replacement shipper, under the same terms and conditions of the releasing shipper's contract, or other mutually agreeable terms and conditions, provided the replacement shipper meets the TSP's creditworthiness and other tariff provisions applicable to the TSP's qualification of a SR to receive service. Such permanent release should be pursuant to the rules, regulations, and policies of the Federal Energy Regulatory Commission (or an equivalent authority) regarding capacity release transactions.

This proposed standard is intended to allow a shipper to permanently release capacity to any replacement shipper that meets the pipeline's creditworthiness and other provisions of the pipeline's tariff. This proposed standard is inconsistent with the

Commission's regulations, would change existing Commission policy, and would potentially cause substantial harm to pipelines.<sup>4</sup>

First of all, this issue is, at best, tangentially related to creditworthiness. The essence of the proposal appears to set a standard for permanent releases. As such, it is beyond the scope of the NAESB Board resolution, as well as the work plan adopted by the Executive Committee for implementing the Board resolution. Second, the proposed standard would violate the Board's prohibition against the development of new policy. Not only would this standard impermissibly set new policy, it would change existing Commission policy.

Section 284.8(f) of the Commission's Regulations provides as follows:

Unless otherwise agreed by the pipeline, the contract of the shipper releasing capacity will remain in full force and effect, with the net proceeds from any resale to a replacement shipper credited to the releasing shipper's reservation charge. 18 C.F.R. § 284.8(f).

Thus, the Commission's regulations provide that a shipper is not relieved of liability under its contract when it releases capacity, unless the pipeline agrees to do so. The proposed standard, however, could be read to relieve the releasing shipper from its obligations under its contract with the pipeline so long as the replacement shipper met the creditworthiness and other tariff provisions applicable to the pipeline's qualification of a shipper to receive service. Thus, contrary to the regulations, the pipeline would no longer have the discretion to agree or not agree to such discharge. Commission policy also supports the pipeline's right to exercise its discretion based on the individual facts and circumstances or each release transaction. In *Texas Eastern Transmission Corp.*, 82

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<sup>4</sup> To the extent that the standard itself requires permanent releases to be performed pursuant to Commission regulation and policy, the standard is internally inconsistent.

FERC ¶ 61,118, *reh'g denied*, 83 FERC ¶ 61,092 (1998), the Commission held that the decision as whether to relieve a releasing shipper from liability from its contract is within the pipeline's discretion, provided that the pipeline's decision is not unreasonable. Generally, the Commission stated that it would be unreasonable for the pipeline to withhold consent to a permanent release when the pipeline would be financially indifferent to the transfer. 83 FERC at 61,448. Given the facts before it in that case, the Commission found that the pipeline's refusal to discharge the releasing shipper from liability was reasonable because it was not financially indifferent to the transfer. *Id.*

The proposed standard could require pipelines to accept permanent releases in circumstances where the pipeline would not be financially indifferent to the transfer. First, it could require a pipeline to accept a permanent release when the replacement shipper provides far less security than the releasing shipper. As discussed above, a releasing shipper may have provided, for example, a letter of credit up to the cost of new facilities to support the construction of such facilities. After the new facilities are in service, the releasing shipper may seek to permanently release its capacity to a non-creditworthy shipper. Unless the Commission clarifies its policy otherwise, the replacement shipper could, under the proposed standard, meet "the TSP's creditworthiness and other tariff provisions applicable to the TSP's qualification of a SR to receive service" by making a three-month prepayment. The end result would be that the pipeline would lose the substantial security of a creditworthy shipper in exchange for a three-month prepayment.<sup>5</sup> Clearly, the pipeline would not be financially indifferent to

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<sup>5</sup> The fact that the Proposed Standard requires the release to be made "under the same terms and conditions of the releasing shipper's contract" would not necessarily require the replacement shipper to match the same security of the releasing shipper because the releasing shipper's service agreement may not, and typically does not, specify credit requirements. Even if it did, a guarantee from the replacement shipper's

this transfer, yet contrary to *Texas Eastern*, the pipeline would be required to allow the permanent release under the proposed standard.

Second, the standard would appear to require a pipeline to accept a permanent release to a less creditworthy replacement shipper, as long as the replacement shipper is creditworthy under the pipeline's tariff. The problem is that there are varying degrees of creditworthiness. For example, a pipeline may have agreed to construct a major expansion project on the basis of one substantial long-term contract with a AAA rated shipper. That shipper may seek to release its capacity the next year to another shipper that meets the minimum qualifying credit rating in the pipeline's tariff, which could be, for example, BBB-. While that shipper may meet the minimum creditworthiness qualifications under a particular pipeline's tariff, the pipeline may not have undertaken the expansion based on that minimum level of creditworthiness. Again, the pipeline would not be financially indifferent to the transfer, and should not be required to allow such permanent release. Infrastructure development would be inhibited by a policy that denies pipelines the ability to rely on the creditworthiness of its shippers in planning facility projects. Pipelines should continue to be permitted to exercise their own reasonable business judgment as to whether a particular shipper can be relieved of liability on the basis of the unique circumstances of each release transaction, as required by existing Commission policy.

In sum, the Commission has an existing policy on permanent releases. There has been no request for NAESB to develop new policy regarding permanent releases. Therefore, NAESB should not be developing policy on this subject, particularly policy

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parent, for example, may not provide the same level of security as a guarantee from the releasing shipper's parent, depending on the credit status of the respective parent companies.

that is outside the scope of the creditworthiness work plan, and is contrary to existing Commission regulations and policy.

2. Proposed Standard 0.3.zN relates to the types of credit alternatives that shippers can provide to secure or continue service and Proposed Standard 0.3.zP deals with the payment of interest on these credit alternatives. The Pipeline Segment opposes these standards because, taken together, they would require pipelines to pay interest on prepayments and would impair pipelines' ability to collect amounts they are owed in a bankruptcy proceeding.

Proposed Standard 0.3.zN reads as follows

In the event that the Service Requester (SR) is determined to be non-creditworthy by the Transportation Service Provider (TSP), at the SR's option, the SR should provide one or more of the following forms of credit alternatives to receive initial service or continue to receive service:

- (1) guarantee;
- (2) an irrevocable letter of credit; or
- (3) prepayment of service.

Such credit alternative(s) should be acceptable to the TSP, provided that the TSP's acceptance should not be unreasonably withheld, and in accordance with standard industry practices. The TSP and SR may mutually agree that the SR will provide other forms of credit alternatives. In order for a guarantee or an irrevocable letter of credit to be accepted by the TSP, the entity that provides such guarantee or letter of credit must be creditworthy in accordance with the TSP's tariff.<sup>6</sup>

Proposed Standard 0.3.zP reads as follows:

If the Service Requester (SR) provides cash as a credit alternative required by the Transportation Service Provider (TSP) pursuant to NAESB WGQ Standard [0.3.zN], the TSP should pay interest to the SR on the cash principal amount held by the TSP on the

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<sup>6</sup> The Pipeline Segment interprets this standard as applying only to service over existing facilities. For the reasons discussed above, pipelines must have the flexibility to determine the type and amount of credit alternatives needed to ensure recovery of funds expended on new facilities.

total amount of the cash received by the TSP. This cash principal amount should exclude the SR's one-month advance payment to the TSP to continue service after the TSP determines the SR to be non-creditworthy pursuant to the TSP's tariff. At the TSP's sole option and in lieu of the TSP paying interest, the TSP may allow the SR to choose to deposit a cash form of credit alternative in an escrow account where the SR will receive the interest on such cash and the TSP will have access to the cash principal for the assurance of payments to the TSP for its services provided to the SR in the event the SR fails to make such payments.

Because prepayments may be chosen at the shipper's option under Proposed Standard 0.3.zN, and interest must be paid on any cash credit alternative under Proposed Standard 0.3.zP, the effect of both standards read together is that a shipper could choose to provide a prepayment and the pipeline would be required to pay interest on such prepayment. The Pipeline Segment cannot support allowing a prepayment to be at a shipper's option as long as interest must be paid on prepayments.

The Pipeline Segment is aware of the Commission's recent pronouncements that pipelines must pay interest on prepayments. Again, however, these rulings are currently pending on rehearing, and it is not appropriate for NAESB to approve standards which pre-judge the outcome of such rehearing requests. Moreover, the Commission's recent pronouncements fail to recognize significant differences between prepayments and other cash deposits that may be held as security by the pipeline. A prepayment, as the name implies, is a payment for service made in advance. As a payment for service, it is the pipeline's property, and interest is not properly payable to the shipper. The only consideration that the shipper receives in return for its prepayment is the right to receive the agreed-upon pipeline service. This is in contrast to a security deposit, which remains the property of the shipper, subject to the pipeline's right to call on it in the event of a default.

This distinction could be of paramount importance in a bankruptcy proceeding. Indeed, a primary objective of a prepayment is to protect the pipeline if the shipper files for bankruptcy. However, if the pipeline is required to pay interest on prepayments, a bankruptcy court could arguably conclude that the prepayment has been transformed into a security deposit, and that under applicable law the shipper's interest in a security deposit is property of the bankrupt estate. Non-creditworthy shippers may desire to prepay for service in advance, as opposed to providing other credit alternatives, and they should be permitted to do so without converting the payment into a security deposit due to the payment of interest.

The *Florida Gas* cases relied on by the Commission for the proposition that its policy has always been that shippers must be provided with the opportunity to earn interest on prepayments actually recognize the distinction discussed above. The pertinent passage from those cases is as follows:

We also agree with IGF's request that Florida Gas be required to pay interest on any prepayments and to refund the prepayments (with interest) *in the event service is not provided*. Florida Gas must refund, with interest, any prepayment made *in the event Florida Gas does not provide service that it agreed to perform*, or the shipper obtains a satisfactory rating or provides alternative security.<sup>7</sup>

Thus, if a prepayment is never used to pay for service, the Commission appears to be saying that it is tantamount to a security deposit upon which interest then becomes payable. In other words, if the pipeline defaults on its obligation to serve the shipper, the shipper is due back its funds, with interest. The corollary to this proposition is likewise true. If the prepayment is used to pay for service, it is the pipeline's funds and should not

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<sup>7</sup> *Florida Gas Transmission Company*, 66 FERC ¶ 61,140 at 61,261 (1994)(emphasis added). The other case cited by the Commission, *Florida Gas Transmission Company*, 66 FERC ¶ 61,376, at 62,258 (1994) actually speaks to interest payable on *deposits held in escrow*.

accrue interest. Consequently, the Pipeline Segment cannot agree to Proposed Standards 0.3.zN and 0.3.zP because they would require pipelines to pay interest on prepayments that can be made at the shipper's option.

#### **D. CONCLUSION**

The Pipeline Segment supports 21 of the 24 standards passed by a balanced vote of the BPS. Proposed Standard 5.3.zE dealing with permanent releases is beyond the scope of the creditworthiness work plan, as well as the resolution passed by the NAESB, prohibiting NAESB from developing new policy. Proposed Standards 0.3.zN and 0.3.zP should not be included because of the effect that the payment of interest on prepayments would have on a pipeline's ability to collect what they are entitled to from shippers in bankruptcy.

May 16, 2003

## APPENDIX A

Algonquin Gas Transmission Company  
ANR Pipeline Company  
CMS Trunkline Gas Company, LLC  
Colorado Interstate Gas Company  
Columbia Gas Transmission Corporation  
Columbia Gulf Transmission Company  
Dominion Transmission, Inc.  
El Paso Natural Gas Company  
Florida Gas Transmission Company  
Great Lakes Gas Transmission, L.P.  
Gulf South Pipeline Company, L.P.  
Iroquois Gas Transmission System, L.P.  
Kern River Gas Transmission Company  
Kinder Morgan Interstate Gas Transmission, LLC  
Midwestern Gas Transmission Company  
National Fuel Gas Supply Corporation  
Natural Gas Pipeline Company of America  
Northern Border Pipeline Company  
Northern Natural Gas Company  
Northwest Pipeline Corporation  
Panhandle Eastern Pipe Line Company  
PG&E Gas Transmission, Northwest Corporation  
Questar Pipeline Company  
Southern Natural Gas Company  
Tennessee Gas Pipeline Company  
Texas Eastern Transmission, LP  
Texas Gas Transmission Corporation  
Transcontinental Gas Pipe Line Corporation  
Transwestern Pipeline Company  
Viking Gas Transmission Company  
Williston Basin Interstate Pipeline Company  
Wyoming Interstate Gas Company  
Young Gas Storage Company, Ltd.