

May 16, 2003

Executive Committee  
Wholesale Gas Quadrant  
North American Energy Standards Board  
1301 Fannin, Suite 2350  
Houston, Texas 77002

Re: Proposed NAESB Creditworthiness Standards

Dear NAESB Executive Committee Members:

Duke Energy Transmission Corporation (“DEGT”), appreciates its ability to participate through its four wholly-owned U.S. interstate pipeline subsidiaries, Texas Eastern Transmission, LP; Algonquin Gas Transmission Company; East Tennessee Natural Gas Company; and Egan Hub Partners L.P., in NAESB’s efforts to create appropriate consensus creditworthiness standards. NAESB Business Practices Subcommittee (“BPS”) members have worked hard to create the 20 standards that have been presented to the NAESB Wholesale Gas Quadrant Executive Committee for review and for possible presentation to the Federal Energy Regulatory Commission (the “Commission” or “FERC”). Some of the proposed standards presume that Commission policy has already been established and that NAESB is consequently free to develop standards based upon this new policy. However, in some cases the FERC orders upon which this presumption is based were issued on facts specific to a small handful of individual pipelines, whose rate cases were before the Commission. These cases are, moreover, currently subject to rehearing. Should the Commission grant rehearing on its policy, or rule that its individual rulings in this handful of cases will not affect generic policy, the proposed standards that are based on those orders will have to be revisited.

However, DEGT believes that, with one significant exception that crosses the line into the development of policy, the standards can be adopted as proposed, subject to certain other smaller changes. DEGT has described these additional changes in the attached memorandum. DEGT supports the comments filed by the NAESB Pipeline Segment, and DEGT offers this letter and the attached Memorandum to supplement the general comments filed by the pipelines.

**A. Proposed Standard 5.3.zE Should Be Rejected.**

Proposed Standard 5.3.zE requires the pipeline to allow a shipper at any time to substitute, by way of a permanent capacity release, any other shipper if that other shipper meets the pipeline’s minimum creditworthiness provisions. Proposed Standard 5.3.zE intrudes directly into the business relationship of the pipeline and its shippers. This proposed rule for permanent capacity release is contrary to FERC policy and precedent, and has no legitimate place in NAESB’s deliberations.

In addition, Proposed Standard 5.3.zE would have negative policy implications if adopted, and is likely contrary to the Natural Gas Act. Proposed Standard 5.3.zE would alter the balance of financial risks between pipelines and shippers, thereby harming pipelines’ willingness and ability to finance

construction of needed infrastructure. Consequently, Proposed Standard 5.3.zE should be eliminated from the set of standards ultimately presented to the Commission.

1. Proposed Standard 5.3.zE is Outside NAESB's Scope.

NAESB is a part of and is accredited by the American National Standards Institute ("ANSI"). One of ANSI's basic guiding principles states that:

Provisions involving business relationships between buyer and seller such as guarantees, warranties and other commercial terms and conditions shall not be included in an American National Standard.

(ANSI Procedures For the Development and Coordination of American National Standards, January 2002, as modified March 2002, 1.2.11.). Given these restrictions under ANSI, it was appropriate that the NAESB Board narrowly scoped the charter to develop new standards such that the new standards would reflect only existing and new Commission policy. If placed into effect, however, Proposed Standard 5.3.zE would contradict existing FERC policy and precedent. It would intrude upon the contractual bargain made between pipelines and their shippers, and would alter the parties' original apportionment of risks. Adoption of this proposed standard will have negative policy implications and it is clearly outside NAESB's authority under ANSI and its own Board charter to approve such a provision.

2. Proposed Standard 5.3.zE is Contrary to Important Precedent.

The fact that Proposed Standard 5.3.zE establishes policy already gives the Executive Committee more than enough reason to reject Proposed Standard 5.3.zE outright. The Executive Committee should, however, also consider *why* the Commission permits pipelines to veto permanent releases when such a veto is reasonable. The Commission ruled in *Texas Eastern Gas Transmission Co.*, 83 FERC ¶ 61,092 (1998) ("*Texas Eastern Declaratory Order*") that pipelines were allowed to reject a permanent assignment where such assignment is not reasonable to the pipeline. The Commission ruled further that Texas Eastern's decision to reject the permanent release proffered by its customer, where the replacement customer met minimum creditworthiness requirements but where the replacement customer was inferior in its credit standing to the releasing shipper, was a "reasonable" decision by the pipeline.

A review of the facts of the *Texas Eastern Declaratory Order* proceeding reveals the importance of that decision to the industry, as well as the inherent dangers to the industry in weakening that precedent. The *Texas Eastern Declaratory Order* allows pipelines the ability, where possible, to preserve the integrity of their long-term contracts, and to maintain the proper balancing of risks and expectations between themselves and their shippers. In the *Texas Eastern Declaratory Order*, the pipeline sought a declaratory order that Texas Eastern was acting reasonably by deciding to reject an assignment by one of its large local distribution company ("LDC") customers of all of the LDC's transportation and storage contracts. At the time of the requested permanent release the LDC held approximately \$4.5 billion in capital assets and had an investment grade credit rating. The LDC's affiliate, to which these valuable contracts would be assigned, was a subsidiary that *had no assets* and *had no employees*.

One of the contracts which the LDC sought to release was for service over facilities that Texas Eastern had only recently constructed. The new facilities were constructed specifically to serve the LDC

and others, and that construction project cost Texas Eastern approximately \$200 million to construct. The LDC was the project's largest customer, and the LDC held a 20 year long agreement to take service on the facilities. The LDC agreement largely underwrote the new facilities and was a significant factor in Texas Eastern's decision to undertake the new construction project in the first place. After receiving only three years of service under the 20 year project contract, the LDC informed Texas Eastern that the LDC would be making permanent assignment of this and all its other agreements to its affiliate.

In the *Texas Eastern Declaratory Order*, the Commission found that it was reasonable for Texas Eastern to reject the assignment notwithstanding the affiliate's compliance with the pipeline's minimum creditworthiness provisions. The Commission found that the pipeline was acting reasonably since the pipeline's long-term contract with the LDC represented considerably greater value than just the minimum security deposit necessary to meet Texas Eastern's minimum creditworthiness requirements. *Texas Eastern Declaratory Order* 83 FERC at 61,448 (1998). See also *National Fuel Supply Corp.*, 85 FERC ¶ 61,439 (1998) Proposed Standard 5.3.zE, if adopted, would inappropriately shift additional contractual risks to pipelines and would erode the reliability of long-term contracts.

Proposed Standard 5.3.zE is also contrary to common law principles governing assignments. As the Commission properly recognized in the *Texas Eastern Declaratory Order*, unless an obligee (the pipeline) agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor (shipper) by the person delegated discharges any duty or liability of the delegating obligor. It is a key tenet of contract law that an assignment of contract which fundamentally changes the allocation of risk under the contract is invalid. The NGA and the Commission's regulations are founded on private contract, and pipelines are entitled to rely upon their bargains with their shippers. NAESB standards should not create opportunities for gaming by shippers wishing to shift additional risk of contract performance to the pipeline. Proposed Standard 5.3.zE would do precisely that, however.

### 3. *Proposed Standard 5.3.zE Has Negative Policy Implications.*

Adoption of Proposed Standard 5.3.zE would have negative consequences for pipelines, lenders, existing creditworthy shippers (which will be forced to share in the costs of defaulting shippers), future shippers that desire the addition of capacity, and for the Commission's contract-based regulatory regime. If adopted, Proposed Standard 5.3.zE would allow creditworthy shippers on interstate natural gas pipeline to avoid their long term agreements. This would have a cascading rate effect for remaining customers on the system who, in order to avoid cost shifts as assignees defaulted on their contract obligations, may be forced to make a similar assignment.

The existence and reliability of long-term contracts are vital to the interstate natural gas industry and fundamental under the Natural Gas Act. Long-term contracts have been traditionally required in order to obtain Commission authorization for the construction of new facilities and to secure necessary financing. Such long-term contracts are required to underpin and justify the Commission's grant of certificate authorizations under Section 7 of the NGA. Shippers should not be handed the ability to avoid their long-term contractual duties by the simple expedient of a permanent release.

The treatment of permanent releases required under Proposed Standard 5.3.zE violates several FERC precedents and if established as general policy would unfairly increase pipeline contract risk.

**B. The Proposed Standards Need Additional Clean-up.**

The need still exists to consider edits and revisions to the proposed standards. As they currently stand, the proposed creditworthiness provisions are ambiguous in several places and at times appear to unnecessarily complicate processes related to credit evaluation. DEGT urges the NAESB WGQ Executive Committee to review the proposed changes addressed in the attached memorandum, and to make the appropriate alterations to the final Executive Committee draft.

Again, DEGT appreciates this opportunity to comment upon the proposed creditworthiness standards. DEGT would be happy to discuss any of its proposals, and the undersigned is available to answer any questions related to the contents of this letter or the attached standard-by-standard commentary.

Sincerely,

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Richard J. Kruse  
Duke Energy Gas Transmission Corp.  
5400 Westheimer Court  
Houston, TX 77056  
(713) 627-5368

MEMORANDUM

May 16, 2003

To: NAESB Wholesale Gas Quadrant Executive Committee

From: Duke Energy Gas Transmission Corp. (“DEGT”)

Re: DEGT Revisions to Creditworthiness Standards Proposed as of 4/21/03

The following represents DEGT’s standard-by-standard commentary upon each of the NAESB proposed creditworthiness standards. For the most part, these comments provide general edit and “clean-up” revisions that do not substantively alter the proposed standards. Where appropriate, however, DEGT has proposed changes that clarify specific obligations between the parties. Following the proposed revisions are comments explaining, on a standard-by-standard basis, why the proposed changes are appropriate.

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**Proposed Standard 0.3.zA**

For credit evaluation purposes, the Service Requester (SR) should supply any of the following information as specified by the Transportation Service Provider (TSP):

Audited Financial Statements;

Annual Report;

Most recent filed statements with the Securities and Exchange Commission (or an equivalent authority) or such other publicly available information;

For public entities, the most recent publicly available interim financial statements, with an attestation by its Chief Financial Officer, Controller, or equivalent (CFO) that such statements constitute a true, correct, and fair representation of financial condition prepared in accordance with Generally Accepted Accounting Principles (GAAP) or equivalent;

For non-public entities, including those that are state-regulated utilities, the most recent available interim financial statements, with an attestation by its CFO that such statements constitute a true, correct, and fair representation of financial condition prepared in accordance with GAAP or equivalent;

For non-public entities, including those that are state-regulated utilities, an existing sworn filing, including the most recent available interim financial statements and annual financial reports filed with the respective regulatory authority, showing the SR’s current financial condition;

For state-regulated utility local distribution companies, documentation from their respective state regulatory commission (or an equivalent authority) of an authorized gas supply cost recovery mechanism which fully recovers both gas commodity and transportation capacity costs and is afforded regulatory asset accounting treatment in accordance with GAAP or equivalent;

List of Affiliates, Parent Companies, and Subsidiaries;

Publicly Available Credit Reports from Credit and Bond Rating Agencies;  
Private Credit Ratings, if obtained by the SR;  
Bank References;  
Trade References;  
Statement of Legal Composition;  
Statement of Length of Time Business has been in Operation;  
Such other information as may be mutually agreed to by the parties; and  
Such other information as the TSP may receive approval to include in its tariff ~~or general terms and conditions.~~

Non-public information ~~supplied~~**provided** by the SR to the TSP, and clearly identified by the SR to the TSP as confidential, should be treated by the TSP as confidential.

[The TSP will not necessarily know which documents are considered confidential by the SR and which documents are not considered confidential. It is more fair and efficient if the shipper initially identifies the documents that it considers to be confidential in nature. A pipeline tariff is a set of documents that includes the pipeline's rate schedules and general terms and conditions.]

#### **Proposed Standard 0.3.zB**

If the Transportation Service Provider (TSP) requests additional information to be used for credit evaluation after the initiation of service, the TSP should provide its reason(s) for requesting the additional information to the Service Requester (SR). The TSP and the SR may mutually agree to waive the requirements of this standard.

#### **Proposed Standard 0.3.zC**

Upon receipt of ~~a~~**either an initial or follow-up** request from the Transportation Service Provider (TSP) for information to be used for credit evaluation, the Service Requester's (SR) authorized representative(s) should acknowledge receipt of the TSP's request. The TSP and the SR may mutually agree to waive the requirements of this standard.

#### **Proposed Standard 0.3.zD**

The Service Requester's (SR) authorized representative(s) should respond to the Transportation Service Provider's (TSP) request for credit information, as allowed by the TSP's tariff, on or before the due date specified in the request. The SR should provide all the credit information requested by the TSP or provide the reason(s) why any of the requested information was not provided.

#### **Proposed Standard 0.3.zE**

Upon receipt from the Service Requester (SR) of all credit information provided pursuant to NAESB WGQ Standard [0.3.zD], the Transportation Service Provider (TSP) should notify the SR's authorized representative(s) that it has received such information. The TSP and the SR may mutually agree to waive the requirements of this standard.

#### **Proposed Standard 0.3.zF**

The Service Requester (SR) should designate up to two representatives who are authorized to receive notices regarding the SR's creditworthiness pursuant to NAESB WGQ Standard [0.3.zE] and should provide to the Transportation Service Provider (TSP) the Internet e-mail addresses of

such representatives prior to the initiation of service. The obligation of the TSP to provide creditworthiness notifications is waived until the above requirement has been met. ~~The SR should manage internal distribution of any creditworthiness notices that are received.~~

### **Proposed Standard 0.3.zG**

Upon the Transportation Service Provider's (TSP) determination that a Service Requester (SR) is non-creditworthy, the TSP should provide the SR with written notification that ~~clearly~~ states the reason(s) for the TSP's ~~decision~~ determination.

### **Proposed Standard 0.3.zH**

At the time of its request for service and upon the Transportation Service Provider's (TSP) request at any time thereafter, the Service Requester (SR) should confirm to the TSP whether any of the following conditions exist:

- (1) that the SR has filed for bankruptcy protection and/or is operating under any chapter of the bankruptcy laws;
- (2) that the SR is subject to liquidation or debt reduction procedures under governing laws, such as an assignment for the benefit of creditors or any creditors' committee agreement; and/or
- (3) that the SR's credit rating has been downgraded by a credit rating agency within the last six months.

### **Proposed Standard 0.3.zI**

Upon request of the Transportation Service Provider (TSP), the Service Requester should furnish the applicable information requested in NAESB WGQ Standards [0.3.zA] and [0.3.zH], including an explanation for any unavailable information, within three (3) business days or such later date acceptable to the TSP.

### **Proposed Standard 0.3.zJ**

In complying with information requirements specified by the Transportation Service Provider (TSP) pursuant to NAESB WGQ Standards [0.3.zA] and [0.3.zH], the Service Requester (SR) should provide to the TSP the public documents that contain the required information. The public documents may be either the SR's public documents or, if the SR does not have the required documents, the public documents of the SR's parent company, to the extent that such documents contain the required information pertaining to the SR. If the SR provides its parent company's public documents to confirm the existence of an event specified in Standard [0.3.zH], the SR should specify where, in said public document, such information appears.

### **Proposed Standard 0.3.zK**

At any time after the Service Requester (SR) is determined to be non-creditworthy by the Transportation Service Provider (TSP), the SR may initiate credit status re-evaluation by the TSP. As part of the SR's re-evaluation request, the SR should either update or confirm in writing the prior information provided to the TSP related to the SR's credit status. Such update should include any substantial event(s) that the SR believes could lead to a change in the SR's credit status.

### **Proposed Standard 0.3.zL**

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.

### **Proposed Standard 0.3.zM**

For the Service Requester (SR) to receive initial service or to continue to receive service from a Transportation Service Provider (TSP), the SR should be

- (1) creditworthy in accordance with the TSP's tariff or provide credit alternative(s) in accordance with NAESB WGQ Standard [0.3.zN],
- (2) current on all undisputed payments to the TSP for service, and
- (3) otherwise in compliance with the TSP's tariff or service agreement.

### **Proposed Standard 0.3.zN**

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, standby 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, and must maintain such creditworthiness throughout the time period that TSP continues to rely upon the credit alternative provided by SR to TSP pursuant to this standard [0.3zN]

[There are several different types of letters of credit, and the type that the pipeline will be wanting from the shipper is a *standby* letter of credit.]

### **Proposed Standard 0.3.zO**

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.

### **Proposed Standard 0.3.zP**

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 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.

### **Proposed Standard 5.3.zA**

A Transportation Service Provider (TSP) can terminate any capacity release transaction if the original Service Requester's (SR) underlying service agreement is terminated due to original SR's default and/or failure to maintain creditworthiness, provided, however, that service by the ~~release shall~~ TSP to the replacement shipper should not terminate if the replacement shipper, within [x] business days from TSP's notification to replacement shipper of the original SR's terminated notice agreement, enters into a new contract directly with the TSP under which the replacement shipper agrees to take service under the Rate Schedule applicable to service previously provided to the original SR, and to pay, for the remaining term of the replacement shipper's ~~contract~~ release agreement, on the lower of the following:

- (1) the original SR's contract rate, or
- (2) the maximum tariff rate applicable to the original SR's capacity, ~~or,~~
- (3) ~~some other rate that is acceptable to the TSP.~~

The TSP should give the replacement shipper notice before terminating service, to the original SR; as specified in the TSP's tariff. This standard does not address releases, which should be governed by the TSP's tariff.

[The revision makes this proposed standard consistent with the Commission's precedent on the replacement shipper's rights to continued service where the original agreement has been cancelled. See, e.g., *Tenaska Ventures v. Northern Border Pipeline Co.*, 99 FERC ¶ 61,182 at 61,709 (2002); *Northern Natural Gas Co.*, 102 FERC ¶ 61,075 at P 71 (2003).]

### **Proposed Standard 5.3.zB**

With respect to non-permanent releases of capacity, the Transportation Service Provider (TSP) should evaluate the creditworthiness status of the replacement shipper(s) to determine qualification as ~~if that a~~ replacement shipper(s) ~~was applying for comparable capacity with~~ pursuant to the terms and conditions of the TSP ~~outside of the capacity release process's~~ tariff.

[Proposed Standard 5.3.zB states that with respect to non-permanent releases, the pipeline should evaluate the creditworthiness status of the replacement shipper as if that replacement shipper "was applying for comparable capacity with the TSP outside of the capacity release process." Proposed Standard 5.3.zB improperly requires a higher level of creditworthiness scrutiny for replacement shippers than the level of scrutiny that is actually required under FERC regulation.]

[Pursuant to Order No. 636, pipelines are not required to make an extensive analysis of the creditworthiness of a replacement shipper. In fact, tariffs generally have provisions allowing releasing shippers to make pre-arranged releases that entirely bypass any creditworthiness scrutiny by the pipeline. The releasing shipper is responsible for all defaults made by replacement shippers, except in the permanent release context. Moreover, the FERC intended that pipelines remain financially indifferent to releases of capacity.]

[It is important that the NAESB standards match up with regulation and precedent concerning the level of scrutiny that a pipeline owes its releasing shippers when the pipeline

[makes creditworthiness determinations about replacement shippers. It is beyond NAESB's scope of authority to place new responsibilities on pipelines beyond the responsibilities pipelines are currently obligated to meet.](#)

### **Proposed Standard 5.3.zC**

As a pre-condition to bid on posted capacity release offers, the Service Requester (SR) should seek to pre-qualify its status with the Transportation Service Provider (TSP) as a potential replacement shipper. Upon request by the SR, the TSP should determine whether a potential replacement shipper is pre-qualified up to a requested level taking into account all obligations from services that it receives and requests from the TSP, including any service represented by the capacity release. Pre-qualifications are subject to periodic re-evaluation by the TSP.

### **Proposed Standard 5.3.zD**

The Transportation Service Provider (TSP) should not award capacity release offers to the Service Requester (SR) until and unless the SR meets the TSP's creditworthiness requirements applicable to all services that it receives from the TSP, including the service represented by the capacity release.

### **Proposed Standard 5.3.zE**

~~The Transportation Service Provider (TSP) should allow an existing Service Requester (SR) permanently release capacity to a replacement shipper, under 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.~~

[\[DEGT proposes that this provision be removed in its entirety. The reasons for this proposal are described at length in DEGT's May 16, 2003 letter to the NAESB Executive Committee.\]](#)

### **Proposed Standard 5.3.zF**

The Transportation Service Provider (TSP) should provide the releasing shipper with Internet E-mail notification reasonably proximate in time with [any of the following](#) formal ~~notice~~[notices](#) given [by TSP](#) to ~~its~~[such releasing shipper's](#) replacement shipper(s), of the following:

- (1) ~~Past~~[Notice to the replacement shipper regarding replacement shipper's past](#) due, deficiency, or default ~~notice~~[status](#) pursuant to the TSP's tariff;
- (2) ~~Suspension~~[Notice to the replacement shipper regarding replacement shipper's suspension](#) of service ~~notice~~;
- (3) ~~Contract~~[Notice to the replacement shipper regarding the replacement shipper's contract](#) termination ~~notice~~-due to default or credit-related issues;
- (4) Notice that a request for information has been initiated by the TSP for the purpose of ~~credit~~[re-evaluation of the replacement shipper's credit](#), excluding routine communication related to credit maintenance or new service; and
- (5) Notice [to the replacement shipper](#) that ~~a~~[the](#) replacement shipper(s) is no longer creditworthy and has not provided credit alternative(s) pursuant to the TSP's tariff.

**Proposed Standard 5.3.zG**

The releasing shipper should provide the Transportation Service Provider (TSP) with the Internet E-mail address of up to two authorized representatives who are designated to receive notification pursuant to NAESB WGQ Standard [5.3.zF]. The obligation of the TSP to provide notifications related to Standard [5.3.zF] is waived until the above requirement has been met. ~~The releasing shipper should manage internal distribution of such notices that are received.~~

**Proposed Modified Standard 5.3.zH**

In complying with the notifications pursuant to NAESB WGQ Standard [5.3.zF], the releasing shipper and the Transportation Service Provider may mutually agree to other forms of communication in lieu of Internet E-mail notification.

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