

Comments of the Baltimore Gas & Electric Company to the NAESB Wholesale Gas Quadrant's Proposed Creditworthiness Standards

General Overview

The NAESB Wholesale Gas Quadrant (WGQ) has admirably undertaken a very cumbersome task in proposing standards for creditworthiness in a market environment with many distinct viewpoints on the subject. In formulating the proposed creditworthiness standards, Baltimore Gas & Electric applauds the WGQ's efforts for attempting to maintain the balance between putting forth provisions to help promote fair and equitable treatment of all counterparties requesting credit and ensuring the right of each counterparty extending credit to decide for itself the amount of credit risk that is prudent to take on a requesting counterparty.

As a company, Baltimore Gas & Electric holds that the determination of creditworthiness and the decision on the amount of credit to extend are inherently proprietary. Given the same set of information on a Service Requester (SR) as provided under Proposed Standard 0.3zA, the credit lines extended by Transportation Service Providers (TSPs) will inevitably vary based on each entity's internal credit policies and how they determine the credit quality of the SR. It is noteworthy that given a great deal more information and access to senior management, the ratings agencies often times disagree as to the creditworthiness of a counterparty. Certainly, we cannot expect a consensus among all the different players in this industry as to how credit should be extended. And we should not set arbitrary policies, which will exact a higher overall cost of credit, shrink market liquidity, and/or lead to counterparties having to take on more credit risk than they would deem prudent. In reviewing the standards proposed by the WGQ, Constellation commends the group for not venturing too deeply into the actual determination of creditworthiness and not trying to invoke arbitrary standards, such as being investment grade in order to be creditworthy. It is our belief that the fact that an entity is rated below-investment grade should not necessarily equate to that counterparty being non-creditworthy.

Baltimore Gas & Electric is also a strong supporter of the view that credit is a bilateral relationship. We realize that for the purpose of simplification, NAESB has framed the recommendations in terms of the Service Requester asking for credit and the Transportation Service Provider, as the entity extending credit. Rarely, if ever, is credit solely being extended on a unilateral basis. Particularly in wholesale marketing and trading where under most contracts there is a liquidation value for the forward value of a contract, the credit risk could lie with either the buyer or the seller. Baltimore Gas & Electric wishes to make sure we are not oversimplifying the issues surrounding credit risk management by reflecting them in the staid, tariff-driven world of interstate gas pipelines and focusing on a static, unilateral credit relationship, when we all operate in a much more complex, bilateral credit environment.

Proposed Standard Comments

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.

One month advance payments or any prepayments should be included in the calculation of interest payments. After all, prepayment and the posting of cash collateral are essentially the same thing. A counterparty is providing cash up front in order to receive the commodity or service. If the cash is designated as collateral and the counterparty fails to make payment when due, the collateral will be used to pay the invoice. Therefore, the cash collateral is a held prepayment.

It is standard industry practice to discount prepayments to a negotiated present value of the future payment due. If this were not the case, then it would always be advantageous to post cash collateral and receive the interest and prepayment would no longer make economic sense. Through this practice, the industry already recognizes that interest should be paid on prepayments.

Proposed Standard 5.3.zA

A Transportation Service Provider (TSP) can terminate any release if the original Service Requester's (SR) underlying service agreement is terminated due to default or failure to maintain creditworthiness, provided, however, that the release shall not terminate if the replacement shipper agrees to pay, for the remaining term of the replacement shipper's contract, one of the following:

- (1) the original SR's contract rate,
- (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, as specified in the TSP's tariff. This standard does not address re-releases, which should be governed by the TSP's tariff.

The TSP should not have the unilateral right to terminate a capacity release if the original capacity holder is non-creditworthy. The existence of this termination right could lead to the capacity release secondary market effectively evaporating through the exit of many players who would be unwilling to buy capacity from counterparties who may be viewed as teetering on the edge of creditworthiness. These NAESB provisions should not be so far-reaching as to dictate to counterparties what types of business and transactions they can enter into.

Thank You for your consideration of these comments

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