

## **Comments 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, Constellation 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, Constellation 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.

Constellation 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. Constellation 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 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) 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.

In our view, there are two distinct scenarios under which a capacity release occurs. In the event that a SR executes a bilateral agreement to release capacity to another specific counterparty, the SR bears the responsibility for understanding the credit risk profile of the new SR and ultimately the default risk. The TSP should be indifferent to the credit quality of the new Service Requester. Even though the new SR will be paying the TSP directly for the released capacity, if that counterparty were to default, the TSP has the right to bill the unpaid amount to the original SR. As the original SR, not the TSP, bears the default risk, it should have the right to sell this capacity to whoever it chooses.

In the event a SR releases capacity back to the TSP for competitive auction, the SR gives up the right to pick the buyer of this capacity. In these auctions, the capacity is awarded to the highest bidder, without necessarily taking into account credit quality of the winner. And the original SR cannot refuse the winner's bid. Therefore, we agree that in this instance, it is amenable to have potential bidders meet the TSP's creditworthiness requirements, so long as the requirements are reasonably founded. An original SR would then have some modicum of assurance that the buyer of the released capacity has met minimum credit requirements.