

131 FERC ¶ 61,271
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

Kern River Gas Transmission Company

Docket Nos. RP09-466-004
RP09-466-000
RP09-466-001
RP09-466-002
RP09-466-003

ORDER ON REHEARING AND COMPLIANCE

(Issued June 25, 2010)

1. On March 20, 2009, Kern River Gas Transmission Company (Kern River) filed revised tariff sheets modifying the creditworthiness provisions of its tariff (March 20 Filing). On May 1, 2009, the Commission accepted the revised tariff sheets, subject to conditions, and required Kern River to submit a compliance filing.¹ On May 29, 2009, Kern River submitted two filings to comply with the May 1 Order. The first was in Docket No. RP09-466-003 and contained revised tariff sheets. The second was in Docket No. RP09-466-002 and provided certain Kern River lending documents requested in the May 1 Order. On June 1, 2009, Nexen Marketing U.S.A. Inc. (Nexen), Williams Gas Marketing, Inc. (Williams), and RRI Energy Services, Inc. (RRI) filed requests for rehearing of the May 1 Order.

2. For the reasons discussed below, the Commission grants in part and denies in part the requests for rehearing. In addition, the Commission accepts the revised tariff sheet in footnote two,² and conditionally accepts the revised tariff sheet in footnote three,³ to be effective April 20, 2009, as discussed below.

¹ *Kern River Transmission Co.*, 127 FERC ¶ 61,103 (2009) (May 1 Order).

² Substitute Fourth Revised Sheet No. 94 to Kern River's FERC Gas Tariff, Second Revised Volume No. 1.

³ Substitute Original Sheet No. 217 to Kern River's FERC Gas Tariff, Second Revised Volume No. 1.

I. Background

A. March 20 Filing

3. In the March 20 Filing, Kern River filed revised tariff sheets to consolidate the creditworthiness provisions of its tariff into a new section 29 of the General Terms and Conditions (GT&C). Section 29.1 of Kern River's proposal set forth how Kern River will determine if a shipper is creditworthy. Sections 29.2 and 29.3 detailed alternate security requirements for non-creditworthy shippers. Section 29.4 addressed how shippers will maintain their creditworthiness status.

4. In addition to consolidating its existing creditworthiness criteria into section 29, Kern River proposed to modify certain provisions. Specifically, in section 29.1, Kern River proposed to (1) add Fitch Ratings to the list of rating agencies used to determine creditworthiness;⁴ (2) require shippers rated by multiple agencies to meet the investment-grade criteria for each agency that rates them; and (3) require shippers with a minimum investment-grade rating to also have a short-term and long-term Outlook⁵ or CreditWatch⁶ of Stable or Positive from each agency rating it at that level.

5. Kern River did not propose any substantive changes to section 29.2, which sets forth the alternate security requirements for non-creditworthy shippers. Section 29.2 states that shippers who do not otherwise meet the creditworthiness criteria may still receive long-term firm service by either (a) furnishing and maintaining for the term of the

⁴ The other two credit ratings agencies in section 29.1 are (1) Moody's Investors Service (Moody's); and (2) Standard and Poor's Corporation (S&P).

⁵ S&P's Outlook ratings assess the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes in the economic and/or fundamental business conditions. The Outlook ratings are (1) Positive, which means that a rating may be raised; (2) Negative, which means that a rating may be lowered; (3) Stable, which means that a rating is not likely to change; or (4) Developing, which means a rating may be raised or lowered. *See* S&P's Ratings Definitions at 11.

⁶ CreditWatch highlights the potential direction of a short-term or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by S&P. Ratings appear on CreditWatch when such an event or a deviation from an expected trend occurs and additional information is necessary to evaluate the current rating. The CreditWatch ratings are (1) Positive, which means that a rating may be raised; (2) Negative, which means a rating may be lowered; or (3) Developing, which means that a rating may be raised, lowered, or affirmed. *Id.* at 11-12.

TSA a written guarantee in a form satisfactory to Kern River from a third party; or
(b) furnishing other security acceptable to Kern River's lenders.

6. Section 29.4 of Kern River's proposal contained entirely new language to address how shippers can maintain their creditworthiness status. Section 29.4 states that Kern River may determine a shipper is no longer creditworthy if, in the reasonable opinion of Kern River, a shipper (or its guarantor) suffers a material adverse change in its financial condition such that the shipper's (or its guarantor's) ability to perform its obligations to Kern River is materially impaired.

B. May 1 Order

7. In the May 1 Order, the Commission accepted Kern River's proposed modifications to section 29.1 without condition. However, the Commission found section 29.2(b), which requires non-creditworthy shippers to furnish other security acceptable to Kern River's lenders, to be ambiguous. The Commission explained that its general policy is that a pipeline may not require non-creditworthy shippers to provide as collateral any more than the equivalent of three months of reservation charges.⁷ However, the Commission noted that for certain project-financed pipelines, lenders require more than three months of collateral from non-creditworthy shippers to better ensure debt repayment.⁸ The Commission explained its policy is that collateral requirements in the precedent agreements apply to the initial shippers on projects and continue in effect after the pipeline goes into service.⁹ The Commission stated that issues relating to collateral for construction projects should be determined in the precedent agreements at the certificate stage, and collateral requirements for new construction should not ordinarily be included in the tariff.

8. The Commission stated that while Kern River's current tariff provides that collateral requirements for new shippers will be determined based on the conditions established by its lenders, Kern River has not demonstrated that its existing lending agreements would justify such a collateral requirement for new shippers. As a result, the Commission directed Kern River to show cause, pursuant to section 5 of the Natural Gas Act, that its current lending agreements justify the application of its current section 29.2(b) to new shippers.

⁷ May 1 Order at P 31 (citing *Policy Statement on Creditworthiness for Interstate Natural Gas Pipelines*, 111 FERC ¶ 61,412 (2005) (*Policy Statement*)).

⁸ *Id.* (citing *e prime, inc. v. PG&E Transmission, Northwest Corp.*, 102 FERC ¶ 61,062, at P 27 (2003) (*e prime*)).

⁹ *Id.* (citing *Policy Statement*, 111 FERC ¶ 61,412 at P 19).

9. The Commission also ordered Kern River to revise section 29.4. Parties protested that the proposed language in section 29.4 gave Kern River too much discretion in determining whether a shipper remains creditworthy. In its answer, Kern River offered to revise section 29.4 to address these concerns by including the following definition of material adverse change:

The determination of “material adverse change” shall be based upon objective, publicly available information or a clearly defined event, such as a default or threat of default on indebtedness, decrease in value of publicly-traded debt, restatement of financials, nonpayment or threat of nonpayment, or decrease in market capitalization.

10. The Commission accepted Kern River’s proposed definition of “material adverse change” and ordered two other revisions to section 29.4. First, the May 1 Order found that section 29.4 must specify that Kern River will notify a shipper in writing of the reason for the change in the shipper’s creditworthiness status, should a material change in financial condition occur. Second, the May 1 Order stated that section 29.4 should provide that if Kern River suspends service for creditworthiness problems, it must also suspend reservation charges. The May 1 Order directed Kern River to revise its tariff sheets accordingly.

II. Requests for Rehearing

11. On June 1, 2009, Nexen, Williams, and RRI filed requests for rehearing of the May 1 Order in Docket No. RP09-466-004.

A. Nexen’s Rehearing Request

12. Nexen argues the Commission erred in accepting the language in section 29.1 requiring minimum-rated investment grade shippers to have a short-term and long-term CreditWatch or Outlook of Stable or Positive. Nexen argues this is too stringent a standard because it will render non-creditworthy any minimum-rated investment-grade shipper who is placed on Negative Outlook or CreditWatch by a ratings agency. Nexen states that instead Kern River should find minimum investment-grade shippers to be non-creditworthy only if they have been placed on Negative CreditWatch.

13. Nexen argues Kern River’s proposal is unsupported because Kern River has not identified a single investment-grade shipper that has been placed on Negative Outlook or CreditWatch and subsequently (1) defaulted on its contractual obligations to Kern River; or (2) failed to provide the additional collateral that Kern River required of non-creditworthy shippers. In addition, Nexen asserts that a Negative CreditWatch or Outlook does not mean a ratings change is inevitable. Nexen argues it is unreasonable to require an investment-grade shipper to maintain additional collateral while the negative

rating remains in place, which could potentially be for a long period, when the shipper may never actually be downgraded. Nexen argues that companies have very little ability to influence ratings agencies to remove negative ratings and should not be burdened with expensive prepayment and collateral obligations in the meantime. Nexen asserts that the costs to an investment-grade shipper of being found non-creditworthy because it is assigned a Negative Outlook outweigh the benefits to Kern River in terms of reduced credit risk.

14. Nexen argues that using CreditWatch is sufficient to protect Kern River from default risk. Nexen explains that companies who have been given a Negative Outlook are almost always placed on CreditWatch first, before they are downgraded. Nexen thus contends that using Outlook is needlessly duplicative of using CreditWatch. In addition, Nexen argues that CreditWatch is a better indicator of a company's future than Outlook. Nexen explains that while Outlook ratings have a longer time horizon and are often left in place for two years or more, CreditWatch ratings reflect the rating's agency's view that a downgrade will occur within the next 90 days. Nexen contends this would provide Kern River with more than enough time to secure additional collateral.

15. Finally, Nexen argues the Commission should not rely on the *Columbia*¹⁰ and *Columbia Gulf*¹¹ decisions to approve Kern River's proposal. Nexen asserts that when the Commission approved the creditworthiness proposals in those orders, the nation's economy was vastly different than it is now. Nexen asserts that given the current economic climate, the Commission should be wary of pipeline proposals, like Kern River's, that force investment-grade shippers to acquire additional credit when the cost of credit has skyrocketed.

16. *Commission Determination.* The Commission denies Nexen's request for rehearing. The Commission finds it reasonable for Kern River to take into account Outlook and CreditWatch ratings when determining whether a minimum investment-grade shipper is creditworthy. While Nexen argues that this is too stringent a standard, the Commission disagrees.

17. CreditWatch and Outlook ratings assess the potential direction of a company's short-term and long-term credit rating. These ratings reflect the agency's degree of confidence that the borrower will be able to meet its promised payments as scheduled.

¹⁰ *Columbia Gas Transmission Corp.*, 119 FERC ¶ 61,041 (2007) (*Columbia*) (accepting tariff language that requires a shipper to have, among other things, a short-term and long-term Outlook of Stable or Positive to be creditworthy).

¹¹ *Columbia Gulf Transmission Co.*, 117 FERC ¶ 61,073 (2006) (*Columbia Gulf*) (accepting tariff language that requires a shipper to have, among other things, a short-term and long-term Outlook of Stable or Positive to be creditworthy).

While Nexen seems to suggest the Outlook and CreditWatch ratings hold little merit, the Commission finds these ratings to be useful tools for parties trying to assess a company's creditworthiness. The ratings are particularly relevant for a pipeline's assessment of the creditworthiness of a minimum investment-grade shipper because they provide an advance signal that the shipper may drop below investment grade. While Nexen is correct that a Negative Outlook or CreditWatch does not mean a ratings decrease is inevitable, it does mean it is a possibility. A poor credit prognosis from either CreditWatch or Outlook is a reasonable indication that a minimum-grade shipper is at greater risk and, therefore, is relevant information for a pipeline to consider.

18. Nexen is concerned about the cost of requiring minimum-rated investment-grade shippers to meet the standards in section 29.1 of Kern River's tariff. However, the Commission finds that standard in section 29.1 is not unduly burdensome. Section 29.1 states that a shipper rated at the minimum investment grade by any ratings agency must have a short-term and long-term Outlook *or* CreditWatch of Stable or Positive from that agency. Thus, a minimum investment-grade shipper who receives a Negative Outlook or a Negative CreditWatch will not automatically be deemed non-creditworthy because section 29.1 requires a Stable or Positive rating from only one, not both, of the ratings agencies. The Commission does not find that requiring a minimum investment-grade shipper to have a Positive or Stable rating for either CreditWatch or Outlook is too strict a standard for pipelines to impose on shippers.

19. Moreover, the Commission disagrees with Nexen's assertion that a CreditWatch rating is sufficient on its own. As Nexen points out, Outlook and CreditWatch consider different time horizons when assigning ratings. CreditWatch is a short-term rating that highlights an emerging situation which may materially affect the profile of a rated corporation. Outlook, on the other hand, assesses the potential direction of a corporation's credit rating over a longer horizon (typically six months to two years). The Commission finds that the longer-term assessment provided by Outlook is equally useful for pipelines, especially when deciding whether to enter into a long-term service contract with a shipper.

20. Nexen argues that rather than relying on *Columbia* and *Columbia Gulf* to approve Kern River's proposal, the Commission should take into consideration the current economic climate and the tightening of available credit and reject Kern River's revisions. The Commission does consider the current state of the economy when reviewing a pipeline's creditworthiness standards. It is for this reason the Commission relied on *Northern 2009*¹² when approving Kern River's proposal, which was issued in an economic climate not unlike the one that existed when the May 1 Order was issued. In *Northern 2009*, the Commission approved the pipeline's use of both CreditWatch and

¹² May 1 Order at P 26 (citing *Northern Natural Gas Co.*, 126 FERC ¶ 61,155, at P 6, 11 (2009) (*Northern 2009*)).

Outlook ratings for assessing creditworthiness, stating that it is reasonable to take into account the credit outlook for a shipper with minimum credit ratings because a poor credit outlook reasonably indicates the shipper is at greater risk.¹³ The May 1 Order is consistent with *Northern 2009*.

21. Finally, Nexen argues Kern River's proposal is unsupported because Kern River fails to provide an example of an investment-grade shipper that has been placed on Negative Outlook or CreditWatch and subsequently defaulted or failed to provide the additional collateral required. However, there is no requirement that Kern River provide such a justification. Kern River need only show that its tariff language for establishing creditworthiness is objective and just and reasonable. For the reasons discussed above, as well as in the May 1 Order, the Commission affirms that the language in section 29.1 meets these standards and denies Nexen's request for rehearing.

B. RRI's Rehearing Request

22. RRI argues the Commission erred in accepting Kern River's proposed definition of "material adverse change" in section 29.4. RRI opposes Kern River's definition because it includes the threat of events, such as the "threat of default on indebtedness" and the "threat of nonpayment." RRI argues this language is not consistent with the *Policy Statement's* requirement that a pipeline use objective criteria in determining whether a shipper is no longer creditworthy.¹⁴ RRI asserts that by definition, a material adverse *change* means that an event impairing shippers' creditworthiness has already occurred, whereas a *threat* is an event that has not occurred and may never occur. In addition, RRI points out that the definition of material adverse change accepted in the May 1 Order is different from the tariff language previously approved by the Commission in *Northern I*.¹⁵ RRI states that the material adverse change language in the Northern tariff does not include the threat of events. RRI contends Kern River's definition of material adverse change vests Kern River with excessive discretion in determining a shipper's creditworthiness and should be modified.

23. In addition, RRI argues the Commission should clarify that, even when an adverse material change does occur, such an event should not automatically mean the shipper is no longer creditworthy. RRI contends Kern River should be required to find that such event actually materially impairs a shipper's ability to pay before the shipper is subject to section 29.4 and deemed not-creditworthy. RRI argues such a requirement is consistent

¹³ *Northern 2009*, 126 FERC ¶ 61,155, at P 11.

¹⁴ *See Policy Statement*, 111 FERC ¶ 61,412 at P 16.

¹⁵ *Northern Natural Gas Co.*, 103 FERC ¶ 61,276 (2003) (*Northern I*).

with the Commission's decision in *Northern II*.¹⁶ Accordingly, RRI requests clarification that should a shipper experience a decrease in market capitalization, a decrease in value of publicly-traded debt, a restatement of financials, or any other similar event, that such event will only qualify as a "material adverse change" if it actually results in the impairment of a shipper's ability to perform its obligations to Kern River.

24. *Commission Determination.* The Commission grants in part and denies in part RRI's request for rehearing.

25. RRI argues the definition of "material adverse change" in section 29.4 should not include the threat of events. The Commission agrees. The *Policy Statement* requires pipelines to use objective criteria in determining whether a shipper is no longer creditworthy.¹⁷ The threat of a default or the threat of non-payment are not sufficiently objective criteria. Because it is unclear what constitutes a threat, the Commission finds that the current definition gives Kern River too much discretion in determining whether a material adverse change has occurred. Thus, the Commission grants RRI's request for rehearing on this issue and directs Kern River to revise section 29.4 to remove the references to threats of default and threats of non-payment.

26. RRI also asks the Commission to clarify that even when an adverse material change does occur, such an event should not automatically mean a shipper is no longer creditworthy. The Commission denies RRI's request for clarification. The first sentence of section 29.4 states that Kern River will only deem a shipper non-creditworthy if the shipper (or its guarantor) suffers a material adverse change in financial condition "*such that shipper's (or its guarantor's) ability to perform its obligations to [Kern River]... is materially impaired*" (emphasis added). Thus, it is already clear from the tariff language that Kern River must use reasonable judgment to determine whether the change that has occurred is one that impairs the shipper's ability to perform its obligations to Kern River and that any other material adverse change in financial condition would not result in a shipper being deemed non-creditworthy. For these reasons, the Commission denies RRI's request for rehearing on this issue.

¹⁶ *Northern Natural Gas Co.*, 102 FERC ¶ 61,076, at P 42 (2003) (*Northern II*) ("simply because a shipper realizes a material adverse change, such as restating its financials, this does not mean that Northern will automatically determine that the shipper is no longer creditworthy since Northern will use its reasonable opinion to determine whether a materially adverse change has occurred.").

¹⁷ See *Policy Statement*, 111 FERC ¶ 61,412 at P 16.

C. Williams' Rehearing Request

27. On June 1, 2009, Williams filed a request for rehearing of the May 1 Order. Williams argues that the proposed revisions to section 29.1, which provide stricter criteria for the establishment of creditworthiness, should not apply to original shippers. Williams argues that such stricter criteria will result in original shippers who were previously deemed creditworthy, such as Williams, to be deemed not creditworthy. Williams explains that despite a long history of timely bill paying, Williams' parent company (which is also Williams' guarantor) will no longer be creditworthy under the new creditworthy standards in section 29.1. Williams explains that as a result, Williams will be required to provide collateral under section 29.2, which requires non-creditworthy shippers to furnish either (1) a written guarantee; or (2) security acceptable to Kern River's lenders.

28. Williams argues this is unreasonable because it allows Kern River to change the creditworthiness criteria for original shippers without any showing that such a change is required by its lenders. Williams states that despite the Commission's explanation that collateral requirements for original shippers on project-financed pipelines are defined in the precedent agreements and should not normally be in the tariff, the Commission permitted Kern River to alter these requirements for original shippers.

29. Williams argues that the only reason to reclassify an original shipper as non-creditworthy is to enable Kern River to require additional collateral from the original shipper. Williams argues Kern River should not be able to require original shippers to provide "other security acceptable to Transporter's lenders" pursuant to section 29.2(b). Williams contends this collateral requirement is vague and subjective and is inconsistent with the *Policy Statement*, which states that pipelines should use objective criteria in determining creditworthiness.

30. Williams asserts it is unjust and unreasonable for the Commission to allow Kern River to unilaterally modify the mutually agreed upon collateral requirements for original shippers. Williams argues that to do so is contrary to the Commission's policy on contractual stability. Williams states that the Commission reinforced the importance of contractual stability in *Reliant*, where the Commission rejected a complaint by a shipper seeking to substitute a form of collateral different from that agreed to by the pipeline.¹⁸ Williams states that in *Reliant*, Kern River asserted its financing documents prohibited it from entertaining changes in collateral. Williams asserts it is inappropriate for Kern River to now seek to alter its collateral requirements without providing evidence that such a requirement exists in its financing documents. Williams states that while it has not reviewed Kern River's financing documents, Williams is confident that there is nothing

¹⁸ Williams' Protest at 5-6 (citing *Reliant Energy Services, Inc. v. Kern River Gas Transmission Co.*, 120 FERC ¶ 61,056 (2007) (*Reliant*)).

in them that required Kern River to file with the Commission to change its creditworthiness criteria applicable to original shippers. Williams states that in the absence of such a requirement, the Commission should have rejected the proposed changes to Kern River's creditworthiness criteria for original shippers as an inappropriate attempt by Kern River to improve upon a bad deal.¹⁹ Williams concludes that Kern River's stricter creditworthiness criteria should not apply to original shippers.

31. *Commission Determination.* The Commission denies Williams' request for rehearing. Williams argues that by allowing Kern River to modify the criteria it uses to determine if a shipper is creditworthy in section 29.1, the May 1 Order improperly permitted Kern River to alter the collateral requirements for original shippers. Williams contends Kern River must provide justification for these changes in its lending documents.

32. In making this argument, Williams confuses the requirements for determining creditworthiness with the collateral requirements for non-creditworthy shippers. The requirements for determining whether a shipper is creditworthy are set forth in section 29.1 of Kern River's tariff. In the March 20 Filing, Kern River proposed to modify these standards to make them stricter.²⁰ The May 1 Order approved these changes as consistent with both the *Policy Statement* and tariff provisions previously accepted by the Commission.²¹

33. The alternative collateral requirements for non-creditworthy shippers are different. As the Commission explained in the *Policy Statement*, these collateral requirements for initial shippers on project-financed pipelines are set forth in the precedent (or some other subsequent) agreement between the shipper and the pipeline.²² Moreover, the

¹⁹ *Id.* at 6 (citing *Reliant*, 120 FERC ¶ 61,056 at P 31 (rejecting complainants' request "to be released from an agreement that they now consider to be a bad deal")).

²⁰ As discussed above, Kern River's proposed modification to section 29.1 included (1) adding a third ratings agency to the list of agencies used to determine creditworthiness; (2) requiring shippers rated by multiple agencies to meet the investment-grade criteria for each agency that rates them; and (3) requiring shippers with a minimum investment-grade rating to also have a short-term and long-term Outlook or CreditWatch of Stable or Positive from each agency rating it at that level.

²¹ May 1 Order at P 26 (citing *Northern 2009*, 126 FERC ¶ 61,155 at P 11).

²² *Policy Statement* at P 19.

Commission made clear that such collateral requirements continue to apply after the pipeline goes into service.²³

34. Here, Kern River did not propose to change any of the collateral requirements in Williams' or any other original shippers' precedent agreements. Nor did it propose any substantive changes to section 29.2, which governs the collateral requirements for new, non-creditworthy shippers. Thus, Williams' argument that the May 1 Order permitted Kern River to change the collateral requirements for original shippers without providing support in its lending documents holds no merit.

35. Moreover, Williams' reliance on the *Reliant* case is misplaced. In *Reliant*, the Commission rejected a shipper's request to change the type of collateral agreed to by the shipper and the pipeline in their precedent agreement.²⁴ The Commission stated that it would be inappropriate to reconsider the amount of collateral after the project-financed pipeline already obtained financing, pledged collateral to its lenders, and completed the project.²⁵ Here, Kern River is not attempting to change the form or the amount of collateral original shippers agreed to in their precedent agreements. Thus, *Reliant* is inapplicable to the instant situation.

36. As explained above, Kern River did seek to change the criteria it uses to determine if a shipper is creditworthy pursuant to section 29.1. These modifications may have changed the trigger for subjecting shippers to the alterative collateral requirements for non-creditworthy shippers. However, nothing prohibits Kern River from revising the criteria it uses to determine that a shipper's status has changed from creditworthy to non-creditworthy, so long as the criteria are objective and just and reasonable and consistent with the *Policy Statement*. Nor must Kern River display justification for such revised criteria in its lending documents. Rather, the Commission may take into account economic conditions for determining whether the new trigger criteria are objective and reasonable, from both the transporter's and the shipper's point of view. The stricter standards for determining creditworthiness accepted by the Commission in the May 1 Order are consistent with Commission policy and did not somehow rewrite collateral requirements for original shippers, as set forth in the precedent agreements. The collateral requirements for original shippers are the same, although the criteria for the need for such collateral have changed. The Commission finds that the new trigger criteria are objective (with minor exceptions to be corrected on compliance), adequately supported, and reasonable. For these reasons, the Commission denies Williams' request for rehearing.

²³ *Id.*

²⁴ *Reliant*, 120 FERC ¶ 61,056.

²⁵ *Id.* P 29.

III. Compliance Filing

37. On May 29, 2009, Kern River submitted two filings to comply with the May 1 Order. The first was in Docket No. RP09-466-002 and provided the lending agreements requested by the May 1 Order. The second was in Docket No. RP09-466-003 and contained the tariff revisions directed by the May 1 Order. The details of these compliance filings are summarized below.

A. Notice and Protests

38. Public notice of Kern River's compliance filing in Docket No. RP09-466-002 was issued on June 2, 2009. Public notice of Kern River's compliance filing in Docket No. RP09-466-003 was issued on June 10, 2009. Protests were due as provided in Rule 211 of the Commission's Rules of Practice and Procedure.²⁶ On June 10, 2009, RRI filed a protest to Kern River's compliance filing providing the lending documents in Docket No. RP09-466-002.

39. On June 24, 2009, Kern River filed an answer to RRI's protest. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure²⁷ prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Kern River's answer because it has provided information that assisted us in our decision-making process.

B. Kern River's Compliance Filing in Docket No. RP09-466-003

40. Kern River's filing in Docket No. RP09-466-003 provided revised tariff sheets in compliance with the May 1 Order. As directed, Kern River modified section 29.4 to (1) include the definition of material adverse change accepted by the May 1 Order; (2) state that it will notify a shipper in writing of the reason for the change in a shipper's creditworthiness status, should a material adverse change in financial condition occur; and (3) specify that if Kern River suspends service for creditworthiness problems, it will also suspend reservation charges. Kern River also made some minor changes to other sections to maintain consistency across parallel provisions.

41. The Commission finds that, except as discussed above with respect to the definition of material adverse change, the revised tariff sheets Kern River filed in Docket No. RP09-466-003 comply with the May 1 Order and are accepted.

²⁶ 18 C.F.R. § 385.211 (2009).

²⁷ 18 C.F.R. § 385.213(a)(2) (2009).

C. Kern River's Compliance filing in Docket No. RP09-466-002

42. Kern River filed its current lending documents with the Commission in Docket No. RP09-466-002 to comply with the May 1 Order. Kern River asserts these lending documents support the collateral requirement in section 29.2(b) for security acceptable to Kern River's lenders.

43. Kern River explains that through the construction of its original pipeline and subsequent system expansions, it has obtained over \$1.3 billion of debt capital. Kern River states that from its initial in-service date in 1992 to present, it has placed into service approximately 1.75 Bcf/day of pipeline capacity. Kern River states that the infrastructure built to provide this capacity is financed with two series of senior notes.²⁸

44. Kern River explains that because it is a project-financed pipeline, it has pledged its existing and future long-term firm transportation service agreements as security for its debt. Kern River explains that its lenders²⁹ do not have conventional first mortgages on the original or expansion assets of the Kern River pipeline and that the physical assets of the pipeline do not stand as collateral for the debt owed by Kern River to its lenders. Kern River states that instead, its financing is secured by a pledge to its lenders of the revenue stream associated with its firm transportation service agreements. Kern River states that it pledged a security interest in all of its long-term firm transportation service agreements and associated shipper credit support, whether those agreements were effective at the time financing occurred or were entered into at a later date during the term of the loans.

45. Kern River states that in addition to guarantees, its lending documents identify two types of security that are acceptable to Kern River's lenders: (1) letter of credit (or equivalent); or (2) cash escrow agreements. Kern River states that in both cases, the security provided must be equal to at least one year of reservation charges.

²⁸ Kern River states that the \$510 million series A notes are debt issued for the construction of the original Kern River system (including the extended term contracts), as well as for the expansion Kern River undertook in 2002. Kern River states that the \$836 million series B notes are debt issued pursuant to a supplemental indenture to the \$510 million series A notes for the purpose of financing Kern River's 2003 expansion. Kern River notes that the series A and B notes are scheduled to be paid off in 2016 and 2018, respectively.

²⁹ Kern River states that its lenders consist of an indeterminate number of unknown persons (anyone from institutions to mutual funds to individuals) who hold the debt, which could have been purchased when initially offered or could have been acquired subsequently in a transaction exempt from registration with the Securities and Exchange Commission. *See* Kern River's May 29, 2009 Filing at n.2.

46. Kern River contends the language in section 29.2, which requires a guaranty or other security acceptable to Kern River's lenders, is consistent with its lending documents. Kern River states that it requires a letter of credit or cash escrow in the amount of one year's reservation charges, as required by its lending documents.

47. Kern River asserts the stricter credit requirements of project-financed pipelines protect not only the lenders, but also the shippers served by the pipeline and, in turn, the gas-consuming public. Kern River claims because of its security requirements, it was able to negotiate financing at a lower interest rate than otherwise would have been required. Kern River asserts that this lower interest rate results in significantly lower costs passed through to shippers in the form of lower transportation rates.

48. Kern River explains that its lending documents do not distinguish between existing and new shippers, between existing and new capacity, or between existing and new credit support. Kern River states that the only distinction made by the lending documents, and therefore by its security policy and by its tariff, is between long-term and short-term transportation agreements.

49. Kern River asserts that *Ozark*,³⁰ *Reliant*,³¹ and the *Policy Statement*³² all recognize that the lending agreements of project-financed pipelines must be honored. Kern River states that it does not believe the *Policy Statement's* brief mention of project-financed pipelines, specifically its reference to "initial shippers,"³³ was meant to exhaust the Commission's views on the subject. Kern River contends its obligation to assign all of its long-term firm transportation agreements to its lenders, regardless of when obtained, clearly reaches beyond "initial shippers." Kern River asserts that given the *Ozark* and *Reliant* precedents, the Commission's approach to project-financed pipelines must be flexible enough to accept the security requirements in Kern River's tariff, which reflect the security requirements in Kern River's lending agreements.

1. RRI's Protest

50. On June 10, 2009, RRI protested the compliance filing in which Kern River provided its lending documents. RRI raises two issues in its protest. First, RRI asserts Kern River's filing does little to resolve the ambiguity in section 29.2(b). RRI states it is not clear from Kern River's filing, or from section 29.2(b), how much collateral in excess

³⁰ Kern River's May 29, 2009 Filing at 3-4 (citing *Ozark Gas Transmission System v. FERC*, 897 F.2d 548 (D.C. Cir. 1990) (*Ozark*)).

³¹ *Id.* at 5 (citing *Reliant*, 120 FERC ¶ 61,056 at P 35).

³² *Id.* (citing *Policy Statement*, 111 FERC ¶ 61,412).

³³ *Id.* (citing *Policy Statement* at P 11).

of three months reservation charges Kern River could require. RRI explains that Kern River suggests in some parts of the filing that its lenders require an amount “equal to *at least one year*” of reservation charges,³⁴ while elsewhere in the filing, Kern River states that shippers will be required to post security *equal to* one year of reservation charges.³⁵ Moreover, RRI asserts the security acceptable to Kern River’s lenders could be changed in Kern River’s lending agreements and given the apparent confidential nature of these agreements, shippers would likely never know or be made aware of the change.

51. As such, RRI argues that section 29.2(b) conflicts with both the *Policy Statement* and *North Baja*.³⁶ RRI explains that the *Policy Statement* requires pipelines to establish and use objective criteria for determining creditworthiness³⁷ and use collateral requirements that are reasonably related to the risk posed by the non-creditworthy shipper³⁸ and that would not unnecessarily cause termination of a shipper’s service.³⁹ RRI states that in *North Baja*, the Commission concluded that a shipper’s failure to meet an excessive collateral requirement could itself result in a request for termination of service and abandonment.⁴⁰

52. RRI asserts that because section 29.2(b) does not comply with these Commission policies, the Commission should direct Kern River to limit security requirements in its tariff to three months of reservation charges. In the alternative, RRI requests the Commission to direct Kern River to clearly define the type and amount of security that would be acceptable to Kern River’s lenders. RRI argues Kern River must use a collateral requirement that is reasonably related to the risk posed by non-creditworthy shippers and is not unduly excessive such that it could possibly result in abandonment of service.

³⁴ RRI’s June 10, 2009 Protest at 2 (citing Kern River’s May 29, 2009 Filing at 9-10 (emphasis added)).

³⁵ *Id.* at 2-3 (citing Kern River’s May 29, 2009 Filing at 7).

³⁶ *Id.* at 3 (citing *North Baja Pipeline, LLC*, 117 FERC ¶ 61,146 (2006) (*North Baja*)).

³⁷ *Id.* at 3-4 (citing *Policy Statement*, 111 FERC ¶ 61,412 at P 10).

³⁸ *Id.* at 4 (citing *Policy Statement*, 111 FERC ¶ 61,412 at P 16).

³⁹ *Id.* (citing *Policy Statement*, 111 FERC ¶ 61,412 at P 13).

⁴⁰ *Id.* at 4 (citing *North Baja*, 117 FERC ¶ 61,146 at P 46 (rejecting a pipeline’s proposal to recover 12 months of collateral from non-creditworthy post-construction shippers)).

53. The second issue RRI raises in its protest deals with the interplay between section 29.2(b) and section 29.4 of Kern River's creditworthy provisions. Specifically, RRI requests that the Commission clarify section 29.4 as it applies to shippers who have guarantors providing the requisite security under Kern River's tariffs. RRI explains that under section 29.4, Kern River may determine that a shipper is no longer creditworthy if a shipper (or its guarantor) suffers a material adverse change in financial condition, such that a shipper's (or its guarantor's) ability to perform its obligations to Kern River may be materially altered. RRI asserts it is not clear how Kern River intends to implement section 29.4 in the event that guarantor of a shipper that has provided a guarantee pursuant to section 29.2(b) becomes non-creditworthy.

54. RRI states that if a long-term firm shipper's guarantor suffers an adverse material change in financial condition, and Kern River were to require that shipper to post additional security acceptable to Kern River's lenders pursuant to section 29.2(b), it is not clear to what extent Kern River would also retain the guarantor's guaranty. In such case, RRI believes Kern River should be required to release the guaranty since it would no longer have the same value and because Kern River would be obtaining security from the shipper itself that is acceptable to Kern River's lenders. RRI states that if Kern River were permitted to retain the guaranty under these circumstances, it would be double-recovering credit support from non-creditworthy shippers, placing them at a disadvantage to other shippers.

55. RRI requests the Commission clarify that where a shipper's guarantor suffers a material adverse change, and the shipper posts additional security pursuant to section 29.2, Kern River must release the guarantor's guaranty. Alternatively, RRI asks the Commission to clarify that in determining the additional security shippers must post under section 29.2(b), Kern River must take into consideration and give shippers credit for any existing guaranties.

2. Kern River's Answer

56. Kern River responds to both issues raised by RRI. With respect to the first issue, Kern River argues that its compliance filing clearly demonstrates that Kern River's commitments to its lenders support a tariff requirement of security *equal to* twelve months of reservation charges for all shippers on its system. However, in light of the RRI's concerns, Kern River offers to revise section 29.2(b) of its tariff to state (new language is underlined):

If a shipper otherwise fails to establish creditworthiness as provided herein, shipper may still receive long term firm service provided it either (a) furnishes and maintains for the term of the transportation service agreement a written guarantee in a form satisfactory to transporter from a third party that is creditworthy as determined above, or (b)

furnishes (i) an irrevocable standby letter of credit in a form acceptable to transporter, or cash, in an amount equal to 12 months of reservation charges under the contract, or (ii) other security acceptable to transporter's lenders.

57. Kern River asserts that adding section 29.2(b)(i) will clarify that security may not exceed the twelve months of collateral that is currently satisfactory to the lenders.

58. With respect to the second issue, Kern River responds that RRI's request for clarification regarding guaranties is irrelevant to the issue in this proceeding, which concerns only whether Kern River's current lending agreements justify the application of its existing tariff provision to new shippers. Moreover, Kern River asserts that RRI's concerns have already been addressed and decided in *Reliant*, where the Commission found that Kern River's lending documents prevent Kern River from unilaterally forfeiting guaranties.⁴¹ Finally, Kern River states that the clarification RRI requests would be inappropriate because a guaranty from a non-creditworthy entity does not qualify as adequate assurance of a shipper's performance.

3. Commission Determination

59. The Commission finds that Kern River's lending documents support a collateral requirement of more than three months' reservation charges for non-creditworthy shippers.

60. Sections 29.2 and 29.3 of Kern River's tariff set forth the collateral requirements for non-creditworthy shippers. Section 29.2 states that long-term firm shippers who are non-creditworthy may still receive service if they either (1) furnish a written guarantee from a third party that is creditworthy; or (2) furnish other security acceptable to Kern River's lenders. Certain parties objected to this language in their protests of the March 20 Filing, arguing it was too vague and did not comport with the Commission's policies on creditworthiness.

61. In the *Policy Statement*, the Commission stated that its general policy is that pipelines may require non-creditworthy shippers to furnish collateral equal to three months of reservation charges.⁴² However, the Commission recognized that pipelines building new or expanded facilities may require higher collateral requirements in order to satisfy lending arrangements.⁴³ The Commission stated that these collateral requirements

⁴¹ Kern River's June 24, 2009 Answer at 3 (citing *Reliant*, 120 FERC ¶ 61,056 at P 32).

⁴² *Policy Statement*, 111 FERC ¶ 61,412 at P 11.

⁴³ *Id.* P 17.

should be contained in the precedent agreement between the pipeline and its expansion shippers, instead of in the tariff, and that such collateral requirements may continue after the pipeline or construction project is in service.⁴⁴

62. Kern River's original system was constructed in 1990 and went into service in 1992. The system underwent two expansions in 2002 and 2003. Kern River secured financing for the original system and the subsequent expansions by pledging its service contracts to its lenders as security, making Kern River a project-financed pipeline. Because Kern River's lending agreements contain strict collateral requirements, it is reasonable for Kern River to demand of its original and expansion shippers greater than three months' reservation charges as collateral. The specific amounts of collateral applicable to original and expansion shippers are set forth in those shippers' agreements with Kern River and have continued after the projects went into service, consistent with Commission policy.

63. The collateral requirements for new shippers (i.e., shippers signing up for service after the pipeline construction or expansion is in service) are set forth in Kern River's tariff. The Commission's general policy is that pipeline tariffs cannot require new, non-creditworthy shippers to provide as collateral any more than three months of reservation charges, even on project-financed pipelines.⁴⁵ The Commission reasoned that the financing requirements necessary for original or expansion shippers are not applicable to shippers on which the pipeline did not rely for financing.⁴⁶

64. As we explained above, section 29.2(b) of Kern River's tariff requires new, non-creditworthy shippers to furnish security acceptable to Kern River's lenders. Because this language is ambiguous and may require new shippers to provide security greater than the Commission's general policy of three-months' reservation charges, the May 1 Order directed Kern River to show cause that its current lending documents support applying section 29.2(b) to new shippers.

65. Kern River submitted its current lending documents in compliance with the May 1 Order. The Commission has reviewed these documents and finds they support a collateral requirement of more than three months reservation charges for new, non-creditworthy shippers. As Kern River states in its filing, its lending documents identify two types of security that are acceptable to Kern River's lenders, in addition to guarantees: (1) letter of credit (or equivalent); or (2) cash escrow agreements. In both

⁴⁴ *Id.* P 18-19.

⁴⁵ *Id.* P 19. See also *Southeast Supply Header, LLC*, 119 FERC ¶ 61,153, at P 43-44 (2007) (*Southeast*); *North Baja*, 117 FERC ¶ 61,146 at P 64.

⁴⁶ *Southeast*, 119 FERC ¶ 61,153 at P 43.

cases, Kern River's lending documents require the security provided to be equal to one year of reservation charges.⁴⁷ Moreover, the lending agreements state that Kern River provided its lenders with a continuing security interest in its service agreements "whether now existing or hereafter arising, now owned or after-acquired, and wherever located...."⁴⁸ Thus, the collateral requirement of one year's reservation charges in Kern River's lending documents applies not only to original and expansion shippers, but also new shippers.

66. Given this, the Commission finds that Kern River's lending documents warrant an exception to the general policy that pipeline tariffs may not impose on new, non-creditworthy shippers a collateral requirement of more than three months' reservation charges. As the *Ozark* decision made clear, it is unreasonable for the Commission to expect pipelines to renegotiate their lending agreements to comply with a later-approved Commission policy.⁴⁹ Because pipelines and their lending institutions have a reliance interests in the collateral pledged for expansion or construction projects,⁵⁰ it is unreasonable for the Commission to question such collateral requirements after financing has been obtained and the project is completed.⁵¹ Here, Kern River relied on the revenue stream from future shippers in obtaining financing, as demonstrated by its lending agreements. The Commission therefore accepts the parameters of Kern River's collateral requirements for new, non-creditworthy shippers.

67. RRI argues the language in section 29.2(b) is too vague and does not comply with the requirement in the *Policy Statement* that pipelines provide objective criteria for establishing creditworthiness. RRI contends the collateral requirements in Kern River's lending agreements could change, and given the confidential nature of those agreements, shippers would never know of the change. In response to RRI's protest, Kern River offered to modify its tariff language to specify that a shipper may provide as collateral "an irrevocable standby letter of credit in a form acceptable to Transporter, or cash, in an amount equal to 12 months of reservation charges...."

⁴⁷ See Attachment E, Trust Indenture, p. 2 (August 13, 2001); Attachment I, \$836M Confidential Offering, Circular/Payoff Letter, p. 41 (April 28, 2003).

⁴⁸ Attachment B, Assignment of Contracts, Pledge and Security Agreement, p. 5, section 2 (August 13, 2001).

⁴⁹ *Ozark*, 897 F.2d at 552.

⁵⁰ *Gas Transmission Northwest Corp. v. FERC*, 504 F.3d 1318, at 1320 (2007) (*GTN*) ("pipelines and their financing institutions' reliance interests for new investment justify the longer collateral requirement [for shippers on project-financed pipelines].").

⁵¹ *Reliant*, 120 FERC ¶ 61,056 at P 29.

68. The Commission agrees with RRI that the current language in section 29.2(b) is vague and should be modified. However, the Commission does not accept Kern River's proposal to modify section 29.2 to include the 12 months of reservation charges requirement. By specifying in section 29.2 the 12-month collateral requirement that exists in the current lending documents, Kern River does not allow for any future changes that may occur to its lending documents or to the collateral requirements therein.

69. Rather, the Commission finds that because Kern River's lending documents specifically apply to new shippers, the language in section 29.2(b) should refer to the collateral requirements in those documents. As such, the Commission directs Kern River to modify section 29.2(b) to state that a non-creditworthy, long-term firm shipper may receive service if it "(b) furnishes security as required by Transporter's current lending documents," and to define "current lending documents" in the definitions section of the tariff. With respect to RRI's concern that shippers will not be aware of any changes to the collateral requirements in Kern River's lending documents, the Commission directs Kern River to provide such information to shippers upon request.

70. RRI also requests clarification regarding the relationship between section 29.2 and section 29.4. As explained above, section 29.2 sets forth the collateral requirements for non-creditworthy shippers. Section 29.4 provides that Kern River may determine a shipper is no longer creditworthy if the shipper (or its guarantor) suffers a material adverse change in financial condition such that shippers' (or its guarantor's) ability to perform its obligations to Kern River is materially impaired.

71. RRI requests the Commission to clarify that where a shipper's guarantor suffers a material adverse change in financial condition pursuant to section 29.4, and the shipper posts additional security pursuant to section 29.2, Kern River must release the guarantor's guaranty. RRI is concerned that Kern River will continue to hold the guarantor's guarantee, while also requiring the shipper to furnish additional security under section 29.2(b). Kern River responds that the issue is irrelevant to this proceeding, which concerns only whether Kern River's lending agreements justify the application of section 29.2(b) to new shippers.

72. The Commission disagrees that RRI's request for clarification is irrelevant to this proceeding. In the May 1 Order, the Commission initiated a review of the just and reasonableness of section 29.2 of Kern River's tariff pursuant to NGA section 5. RRI's request relates to the applicability of section 29.2 when triggered by section 29.4 and, therefore, is relevant to the Commission's inquiry.

73. As Kern River points out, the Commission already determined in *Reliant* that Kern River's current lending documents do not permit Kern River to unilaterally forfeit its guaranties.⁵² While the double recovery of collateral from a non-creditworthy shipper

⁵² *Id.* P 32, n.27 (citing section 6 of the "Assignment of Contracts").

and its former guarantor would not generally be consistent with Commission policy,⁵³ Kern River presents a unique situation because of the requirements in its lending agreements. As we explained above, Kern River and its lenders have reliance interests in their existing lending agreements and the Commission will not question the criteria in those documents at this late stage. For these reasons, the Commission clarifies that in the situation presented by RRI, Kern River is not required to release the guaranty of a non-creditworthy shipper's guarantor because doing so would be inconsistent with Kern River's current lending documents.

The Commission orders:

(A) RRI's request for rehearing is granted in part, as discussed in the body of this order.

(B) The remaining requests for rehearing are denied, as discussed in the body of this order.

(C) The revised tariff sheet in footnote two is accepted, as discussed in the body of this order.

(D) The revised tariff sheet in footnote three is accepted, subject to conditions, as discussed in the body of this order.

(E) Kern River is directed to make a compliance filing within thirty (30) days of the date of this order, as discussed in the body of the order.

(F) Kern River shall, upon request, inform shippers of any changes to the collateral requirements in Kern River's lending documents.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁵³ See *Gas Transmission Northwest Corp.*, 117 FERC ¶ 61,315, at P 23 (2006) (stating the pipeline must permit shippers to use any of the approved forms of collateral listed in the tariff when switching credit alternatives, consistent with the *Policy Statement*, which provides that a pipeline must not unreasonably discriminate in the forms of security it accepts from customers).