126 FERC ¶ 61,181
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Acting Chairman;
Suedeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

Saltville Gas Storage Company, L.L.C.	Docket Nos.	RP08-479-000 and RP08-479-001;
East Tennessee Natural Gas, LLC	Docket Nos.	RP08-487-000 and RP08-487-001;
Algonquin Gas Transmission, LLC	Docket Nos.	RP07-139-000, RP07-139-004, and RP07-139-005 (*Not Consolidated*)

ORDER APPROVING SETTLEMENTS, SUBJECT TO CONDITIONS

(Issued February 26, 2009)

1. On December 17, 2008, Saltville Gas Storage Company, L.L.C. (Saltville), East Tennessee Natural Gas, LLC (East Tennessee), and Algonquin Gas Transmission, LLC (Algonquin) (collectively, "Spectra" or "the Spectra Companies") filed a Stipulation and Agreement (Settlement) in each of the above referenced dockets. As discussed in more detail below, the Commission approves the Settlements, subject to conditions, effective March 1, 2009.

<u>Background</u>

2. On August 1, 2008, Saltville and East Tennessee filed proposed changes to their respective tariffs concerning, among other things, a net present value[1] (NPV) allocation methodology for available capacity to include the probability of default as one of its factors. On August 29, 2008, the Commission accepted and suspended the proposed tariff changes of both Saltville[2] and East Tennessee[3] (the August 29 Orders), subject to

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[1] Net present value (NPV) or net present worth (NPW) is defined as the total present value (PV) of a time series of cash flows. It is a standard method for using the time value of money to appraise long-term projects.

[2] *Saltville Gas Storage Company, L.L.C.*, 124 FERC ¶ 61,209 (2008)

[3] *East Tennessee Natural Gas, LLC*, 124 FERC ¶ 61,210 (2008)

refund and conditions, and subject to the outcome of a technical conference. In both orders, the Commission directed its Staff to convene a technical conference to address the proposed services and terms and conditions.

3. A similar proposal had been made by Algonquin in Docket No. RP07-139-000, *et al*. On February 16, 2007, the Commission accepted and suspended similar proposed changes to Algonquin's tariff, subject to refund and conditions.[4] On July 19, 2007, the Commission accepted a compliance filing by Algonquin, subject to certain modifications.[5] Hess Corporation (Hess) requested clarification and rehearing and Nexen Marketing U.S.A. Inc. (Nexen) requested rehearing of the July 19, 2007 Order. Algonquin filed a motion to answer. Consolidated Edison Company of New York, Inc., and Orange Rockland Utilities filed a reply to Hess' request for clarification. On September 19, 2007, the Commission granted a request for rehearing for further consideration. By the time the August 29 Orders were issued in Saltville and East Tennessee, the Commission had not issued a final order for Algonquin.[6]

4. On September 26, 2008, the Commission issued a Notice of Technical Conference, to address the issues raised in the proceedings for Saltville, East Tennessee, and Algonquin. All three companies are subsidiaries of Spectra. The Technical Conference convened on October 22, 2008. Subsequently, Spectra reported that it met with its customers, and in lieu of comments and reply comments to the technical conference, Spectra filed the instant Settlements.

Description of the Settlements

5. The three Settlements are similar. The Settlements as proposed would settle all issues in the proceedings. Spectra states that the Settlements provide for a modified NPV allocation regime that incorporates a bidder's credit rating[7] to award available capacity. The Settlements include *pro forma* tariff sheets that establish a Risk of Default Factor that is used to discount the bids of customers deemed to be non-creditworthy. The Risk

[4] *Algonquin Gas Transmission, LLC,* 118 FERC ¶ 61,123 (2007).

[5] *Algonquin Gas Transmission, LLC,* 120 FERC ¶ 61,072 (2007) (July 19, 2007 Order).

[6] The Settlement would resolve the issues raised by Hess and Nexen in the Algonquin proceeding.

[7] Spectra states that where a guarantee for all obligations under the relevant service agreement has been provided by the bidder's parent company or guarantor, that parent company or guarantor's credit rating will be used instead.

of Default Factor is found by reading Standard & Poor's *Cumulative Average: Default Rate by Rating Modifier* table[8] for the bidder's credit rating and the term of the bid. The Settlements do not apply the Risk of Default Factor for any bidder with a BBB- or better credit rating.[9] Bidders with credit ratings below BBB- (or its equivalent) also will not be subject to the Risk of Default Factor if they provide one or more year's worth of collateral, reducing the term of years column on the Standard & Poor's table until the resulting probability of default is less than that of a hypothetical shipper rated BBB- who could have submitted an otherwise identical bid.

6. Section 1 of the Settlements provide that, as of the later of the effective date of the Settlements or the date the Commission accepts the instant filings, all issues in the proceedings will be resolved, all protests will be withdrawn, and the proceedings will be terminated with prejudice.

7. Section 2.1 provides that the Consenting Parties agree to the *pro forma* tariff sheets contained in Exhibit 2 to the Settlements.

8. Section 2.2 provides that the Spectra Companies will file tariff sheets with the Commission that are substantively identical to the *pro forma* tariff sheets included with the Settlements within seven business days of the issuance of an order by the Commission accepting the Settlements.

9. Section 3 establishes the effective date of the Settlements as the first day of the first calendar month following the date on which the Spectra Companies receive a final Commission order, no longer subject to rehearing or appeal, approving the Settlements as filed and without condition.

10. Section 4.1 provides that the Settlements represent negotiated settlements of the issues in the proceedings and that the benefits accruing to the Spectra Companies and the Consenting Parties represent compromises by the parties to achieve a balance between competing interests.

11. Section 4.2 provides that Commission approval of the Settlements constitutes a termination of the proceedings in the referenced dockets, and constitutes any and all waivers of the Commission's rules and regulations that may be necessary to effectuate the Settlements.

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[8] *See* Standard & Poor's Ratings Direct, Feb. 5, 2008, at p 11, *available at* https://www2.standardandpoors.com/spf/pdf/products/2007_Default_Study.pdf.

[9] Spectra identifies as "investment grade" a rating of BBB- or better according to Standard & Poor's or its equivalent from another recognized rating agency.

12. Section 4.3 provides that the Spectra Companies and the Consenting Parties retain their full rights under NGA Sections 4 and 5, as applicable, and that the standard of review in any future NGA Section 4 or 5 proceeding shall be the "just and reasonable" standard.

13. Section 4.4 provides that any and all discussions related to the Settlements are privileged and not admissible in evidence unless the Settlements become effective.

14. Section 4.5 states that the process the Spectra Companies use to determine creditworthiness is not changed by the Settlements. Section 4.5 further provides that under the open season bidding process established by the *pro forma* tariff sheets, an entity must post an amount of collateral equal to the greater of (i) the amount required under the then-existing terms of the Spectra Companies' respective tariff, or (ii) the amount indicated by that entity in submitting its bid in accordance with the language approved in the tariff filing. Finally, Section 4.5 states that entities that do not have a rating for long-term unsecured debt from a recognized rating agency will be assigned an equivalent rating using the process described in Exhibit 4 to the Settlements, except that such process will not apply when that entity's parent company or guarantor does have a rating from a recognized rating agency and also provides a guarantee for all of the obligations under the specific service agreement it issues.

15. Section 5 contains representations, warranties, and covenants by the parties regarding their ability to enter into the Settlements, and the actions they will take in supporting the Settlements before the Commission.

Operation of the Settlements

16. As proposed in the suspended tariff sheets and in the Settlements, the Spectra Companies would evaluate bids for available capacity using a Net Present Value (NPV) analysis. The NPV analysis would indicate the total value to the pipeline of any given bid, taking into consideration the rate per Dth, the duration of the proposed service agreement, and the time value of money. After calculating the NPV of a bid, the Spectra Companies would then multiply the NPV by a Risk of Default Factor. The Risk of Default Factor is defined by the Standard & Poor's *Cumulative Average: Default Rate by Rating Modifier* table. Using the credit rating of a bond issuer as the row and the time horizon in years as the column, the Standard & Poor's table shows the rate at which, historically, companies with those ratings have tended to default at any time within a given number of years. Spectra treats the bidder's promise to pay the pipeline over the bid-for number of years as if it were a corporate bond, and thus devalues the NPV by simply multiplying the NPV by one minus the Risk of Default percentage figure from the Standard & Poor's table.

17. The Settlements add another factor not present in the original proposal: Spectra will not apply the Risk of Default Factor and does not reduce a bid by any bidder with a

BBB- or better credit rating.[10] Bidders with credit ratings below BBB- (or its equivalent) may avoid the Risk of Default Factor by providing one or more years' worth of collateral, reducing the term of years column on the Standard & Poor's table until the resulting probability of default is less than that of a hypothetical shipper rated BBB- who could have submitted an otherwise identical bid.

<u>Comments on the Settlements</u>

18. PSEG Energy filed comments in support of all three Settlements. The East Tennessee Group filed comments in support of the Saltville and East Tennessee Settlements. National Grid Gas Delivery Companies and Algonquin filed comments in support of the Algonquin Settlement. Saltville filed comments in support of the Saltville Settlement, and East Tennessee filed comments in support of the East Tennessee Settlement. No adverse comments or protests were filed.

<u>Commission Determination</u>

19. The Commission will approve the settlement subject to conditions relating to the collateral required of shippers with credit ratings less than BBB- (non-creditworthy shippers). In acting on an uncontested settlement, the Commission has a duty to provide "independent consideration of fairness, reasonableness, and the public interest."[11] While the proposed Settlements satisfy these criteria with respect to shippers who are rated BBB- and above, it discriminates against shippers rated less than BBB- by requiring the posting of collateral greater than what is justified by the NPV bid evaluation formula used by the pipeline.

20. The purpose of using NPV to determine the value of a bid is to simplify the stream of future cash flows to a single, present-day dollar figure. NPV takes into account the amount bid for capacity, the quantity bid, and the terms of the bid, and determines the current value of each bid. All else being equal, funds to be received in the future are worth less than funds received presently, and the present value formula permits a fair comparison of bids that may contain differences in rate, quantity and terms of service.

21. The Settlements add to the NPV formula an adjustment for the risk posed by the credit status of the bidder.[12] Under the Proposed Settlements, the NPV for a bid by a

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[10] Spectra identifies as "investment grade" a rating of BBB- or better according to Standard & Poor's or its equivalent from another recognized rating agency.

[11] *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 700 (D.C. Cir. 2007).

[12] *See Policy Statement on Creditworthiness for Interstate Natural Gas Pipelines*, FERC Stats & Regs., Regulations Preambles 2001-2005 ¶ 31,191, at P 15 (2005).

creditworthy shipper (BBB- or above), is not adjusted. However, any bid by a non-creditworthy shipper is reduced based on data contained in Standard & Poor's *Cumulative Average: Default Rate by Rating Modifier* table. This Standard & Poor's table shows the risk of default (at any time during the term of the contract) for a company with each credit rating for a contract of a specified number of years. As shown in the example below, on a 10-year contract, the risk of default for a creditworthy BBB- shipper is 6.91 percent, while the credit rating for a non-creditworthy BB+ shipper is 10.21 percent.

Time Horizon (Years)												
Rating	1	2	3	4	5	6	7	8	9	10	11	12
BBB-	0.31	1.02	1.78	2.78	3.74	4.60	5.25	5.87	6.33	**6.91**	7.42	7.94
BB+	0.52	1.41	2.85	4.20	5.41	**6.71**	7.88	8.41	9.36	**10.21**	10.82	11.41

22. Under the Settlements, the NPV bid for the BBB- shipper would not be adjusted. But the present value of the bid by the BB+ shipper would be reduced by 10.21 percent. Based on the example in the Appendix, (10 year contract, $100 per month bid, 100 Dth contract, and 10 percent cost of money) the present value of the bid would be reduced by $77,260.[13] However, under the Settlements, if the shipper wanted to have its bid weighted at the full NPV value, it would have to put up the contract value ($120,000 per year) for the number of years sufficient to move its risk of default to an number equal to or less than the risk of default for a BBB- shipper. In this example, it would have to put up four years of collateral to reduce its risk of default to equal to or less than 6.91 percent (or $480,000).[14] The Spectra Companies have not provided any justification for their use of the Standard & Poor's table to calculate collateral in this manner, nor have they cited to any literature suggesting that its method for calculating collateral is accepted in the financial markets.

23. We find that valuing the collateral required by the non-creditworthy shipper at the full contractual value by year is not consistent with the use of NPV to value bids. By requiring payment of the full contract price for four years, the Spectra Companies ignore the fact that the risk of default in the early years is entirely eliminated. If this cash was

[13] The Appendix shows the calculation of the bid reduction.

[14] The Appendix shows the calculation of collateral under the Settlements' formula.

recognized in the NPV formula as of the time the collateral is received, its impact on the present value would be at its greatest. As shown above, the NPV formula finds that the difference in the present value attributable to the risk of default over the entire 10-year term of the contract is only $77,260, as compared with the $480,000 the Settlements' require. We therefore find that the Settlements' methodology for determining collateral for non-creditworthy shippers is unjust and unreasonable and unduly discriminatory because it requires collateral far in excess of what is necessary to compensate for the additional risk of default and because it treats collateral as separate and outside the NPV calculation, rather than adjusting the future cash flow for the probability of default.

24. We therefore will approve the Settlements subject to the condition that the Spectra Companies revise the methodology for determining the amount of collateral a non-creditworthy shipper would need to provide in order to avoid a reduction in the NPV of its bids.

25. In addition, we require the Spectra Companies to provide an explanation of the basis upon which they calculate the reduction in bid. Under the Settlements, a bid by a BBB- shipper is subject to no bid reduction although the Standard & Poor's chart would attribute a 6.91 percent risk of default to that contract. On the other hand, the bid by a BB+ shipper would be reduced by the full 10.21 percent. The Spectra Companies need to explain why the bid of the non-creditworthy BB+ shipper is reduced by more than the incremental risk faced by the Spectra Companies in selling to a BB+ shipper rather than a BBB- shipper, in this case the 3.70 percent greater risk. We, therefore, will approve the Settlements under the condition that it either be revised to reflect only the increased risk associated with a non-creditworthy shipper or an explanation for why the settlement provision should be found just and reasonable.

26. The August 1, 2008 tariff sheets filed by Saltville and East Tennessee revising their credit provisions are rejected since these tariff sheets suffer from the same problems as noted above.

The Commission orders:

(A) The Settlements are approved, subject to the conditions as set forth in the body of the order.

(B) The August 1, 2008 tariff sheets filed by Saltville and East Tennessee revising their credit provisions are rejected.

(C) Saltville and East Tennessee are directed to make a filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission. Commissioner Kelliher is not participating.

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix
Assumptions for the Example

Time Horizon (Years)												
Rating	1	2	3	4	5	6	7	8	9	10	11	12
BBB-	0.31	1.02	1.78	2.78	3.74	4.60	5.25	5.87	6.33	**6.91**	7.42	7.94
BB+	0.52	1.41	2.85	4.20	5.41	**6.71**	7.88	8.41	9.36	**10.21**	10.82	11.41

Assume: S1 is BB+ 10.21% risk of default
S2 is BBB- 6.91% risk of default
Shipper 1 and 2 bid: $100 per month
(S1 and S2) 100 Dth/day per month
10 year contract
10% discount factor

Shipper S1, with a BB+ credit rating, and Shipper S2, with a higher BBB- credit rating, make identical 10-year bids for capacity.

NPV Model

NPV of cash flow	$756,712
Proposed S2 BBB- risk adj.	0.0%
S2's NPV	$756,712
S1's BB+ risk adj.	-10.21%
S1's NPV	$679,451

Difference S1-S2 NPV $77,260

S1's and S2's NPV would be $756,712. However, under the Settlements' risk of default adjustment, S1's NPV would be devalued by their S&P Risk of Default (10.21%). S1's risk adjusted NPV bid is reduced by $77,260 to $679,451.

Settlements Collateral Model

Find from the Default Rate table the approximate year for S1's BB+ risk to equal S2's BBB-
S2 BBB- risk adjustment 6.91%
S1 closest BB+ risk. Adj. 6.71% at yr. 6

4 years collateral required calculation

Years	4	X
Per month	$100	X

	Months per yr	12	X
	Dth/day per month	100	
Collateral Required		**$480,000**	

Under the Settlements, in order to avoid this devaluation, S1 would have to provide collateral in years sufficient to produce a risk of default equal to or less than a hypothetical bid by a BBB- credit shipper (S2), which, under the Settlements, would not have their bid devalued at all. In this case, S1 would have to provide four years' of revenues as collateral so that its default risk on the S&P table is approximately equal (or lower) than the risk for a minimally creditworthy BBB- shipper. In this example, the BB+ risk of default percentage would be below the BBB-'s 10-year risk of default at year 6 (BBB- is 6.91% at year 10, whereas BB+ is at 6.71% at year 6). In this example, the collateral under the Settlements would be $480,000 (four years x 10,000 x $100).