UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

North Baja Pipeline, LLC	Docket No. RP02-363-013
e prime, inc. v. PG&E Transmission, Northwest Corporation	Docket No. RP03-41-004
PG&E Transmission, Northwest Corporation	Docket No. RP03-70-008

ORDER ON VOLUNTARY REMAND

(Issued November 1, 2006)

1. In 2002 and 2003, the Commission issued a number of orders in three separate proceedings concerning the creditworthiness provisions of North Baja Pipeline, LLC (North Baja) and PG&E Transmission, Northwest Corporation (GTN).[1] Specifically, the orders denied the pipelines the opportunity to recover 12 months of collateral from non-creditworthy post-construction shippers. North Baja and GTN appealed the Commission's orders and the three appeals were consolidated in *Gas Transmission Northwest Corporation , et al. v. Federal Energy Regulatory Commission*, D.C. Cir. No. 03-1257, *et al.* On March 9, 2006, in response to the Commission's motion, the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued an order granting the Commission's motion for voluntary remand to permit the issuance of a further order. On May 3, 2006, the Commission issued an order directing North Baja and GTN to submit briefs to address certain issues concerning whether North Baja and GTN should be permitted to collect 12 months of collateral from non-creditworthy shippers as opposed to the Commission's general policy of 3 months of collateral for non-

[1] PG&E Gas Transmission, Northwest Corporation has changed its name to Gas Transmission Northwest Corporation (GTN).

creditworthy shippers.[2] This order addresses the issues raised in the joint brief of GTN and North Baja as well as the reply comments filed in this proceeding.

Procedural Background

2. In the orders in *North Baja Pipeline, LLC* in Docket No. RP02-363,[3] the Commission on its own motion under section 5 of the Natural Gas Act (NGA) found that North Baja's tariff requirement that non-creditworthy shippers must post collateral equal to 12 months of reservation charges in order to continue service was unjust and unreasonable. The Commission found "that requiring security equal to twelve months of service charges is excessive for shippers subscribing to service after the pipeline is in operation."[4] The Commission also found that while "requiring twelve months of security may be acceptable in the precedent agreements leading up to the issuance of a certificate, the tariff requirements that apply to shippers once the pipeline is in operation must limit the security requirements to three months of transportation charges."[5] On rehearing, North Baja argued that the Commission did not take into account pipeline-specific facts and circumstances in finding the 12 month collateral requirement unjust and unreasonable, and also failed to conduct an evidentiary hearing to determine North Baja's facts and circumstances. The Commission affirmed its decision applying a 3 month collateral requirement to North Baja and, accordingly, denied rehearing.

3. In the orders in *e prime, inc. v. PG&E Gas Transmission, Northwest Corporation* in Docket No. RP03-41, [6] the Commission granted a complaint by e prime alleging that GTN unlawfully required e prime to provide 12 months of collateral in order to continue service because e prime was found to be non-creditworthy by GTN. The Commission found that GTN's tariff did not provide for 12 months of collateral from non-

---

[2] *North Baja Pipeline, LLC*, 115 FERC ¶ 61,141 (2006).

[3] *North Baja Pipeline, LLC*, 102 FERC ¶ 61,239 (2003), *order on reh'g and clarification*, 105 FERC ¶ 61,374 (2003).

[4] 102 FERC ¶ 61,239 at P 14.

[5] *Id.* at P 15.

[6] 102 FERC ¶ 61,062 (2003), *order accepting compliance filing and granting complaint*, 102 FERC ¶ 61,289 (2003), *order on reh'g and clarification*, 104 FERC ¶ 61,026 (2003).

creditworthy shippers and, therefore, the Commission's general policy of 3 months of collateral would apply.

4. In the orders in *PG&E Gas Transmission, Northwest Corporation* in Docket No. RP03-70,[7] the Commission rejected GTN's filing to require 12 months of collateral for all non-creditworthy shippers. The Commission found that "requiring security equal to twelve months of service charges is excessive for shippers subscribing to service after the pipeline is in operation."[8] The Commission stated that the "policy is that for on-going shippers collateral can be required up to three months of service."[9] The Commission also found that "GTN provided no data to support its contentions that it is similar to project financed pipelines with debt obligations that specifically require a one-year prepayment of transportation charges."[10]

5. On August 23, 2003, GTN petitioned for review of the Commission's orders in *e prime, inc. v. PG&E Gas Transmission, Northwest Corporation* in Docket No. RP03-41. On February 23, 2004, North Baja and GTN filed petitions for review of the Commission's orders in *North Baja Pipeline, LLC* in Docket No. RP02-363, and *PG&E Gas Transmission, Northwest Corporation* in Docket No. RP03-70. On March 30, 2004, the D.C. Circuit consolidated the three proceedings.

6. On March 9, 2006, in response to the Commission's motion, the D.C. Circuit issued an order granting the commission's motion for voluntary remand to permit the issuance of a further order.

Creditworthiness Policy Statement

7. While the appeals in this case were still pending before the court, on June 16, 2005, the Commission issued a policy statement on creditworthiness and withdrew the proposed rulemaking on creditworthiness in Docket No. RM04-4-000.[11] As pertinent

---

[7] 101 FERC ¶ 61,280 (2002), *order on technical conference and reh'g*, 103 FERC ¶ 61,137 (2003), *order on compliance and reh'g*, 105 FERC ¶ 61,382 (2003).

[8] 105 FERC ¶ 61,137 at P 32.

[9] Id.

[10] 105 FERC ¶ 61,382 at P 48.

[11] Policy Statement on Creditworthiness for Interstate Natural Gas Pipelines and Order Withdrawing Rulemaking Proceeding, 111 FERC ¶ 61,412 (2005).

here, the order set forth the policy concerning collateral requirements for non-creditworthy shippers.

8. The Commission stated in the policy statement[12]:

> Since Order Nos. 436 and 636, the Commission's general policy in order to ensure that open access service is reasonably available has been to permit pipelines to require shippers that fail to meet the pipeline's creditworthiness requirements for pipeline service to put up collateral equal to three months' worth of reservation charges.[[13]] The Commission has viewed a customer's on-going credit risk as a business risk of the pipeline that should be reflected in its rate of return on equity.[[14]] The Commission has also recognized that in cases of new construction, particularly project-financed pipelines, [[15]] pipelines and their lenders could require larger collateral

---

[12] Policy Statement on Creditworthiness for Interstate Natural Gas Pipelines, FERC Stats. & Regs [Regulations Preambles] ¶ 31,191 at P 11 (2005).

[13] *See Florida Gas Transmission Co.*, 66 FERC ¶ 61,140 at 61,261 n.5&6, *order vacating prior order*, 66 FERC ¶ 61,376 at 62,257 (1994); *Southern Natural Gas Co.*, 62 FERC ¶ 61,136 at 61,954 (1993); *Valero Interstate Transmission Co.*, 62 FERC ¶ 61,197 at 62,397 (1993); *Texas Eastern Transmission Corp.*, 41 FERC ¶ 61,373 at 62,017 (1987); *Williams Natural Gas Co.*, 43 FERC ¶ 61,227 at 61,596 (1988); *Pacific Gas Transmission Co.*, 40 FERC ¶ 61,193 at 61,622 (1987); *Tennessee Gas Pipeline Co.*, 40 FERC ¶ 61,194 at 61,636 (1987); *Natural Gas Pipeline Co. of America*, 41 FERC ¶ 61,164 at 61,409, n.4 (1987); *Northern Natural Gas Co.*, 37 FERC ¶ 61,272 at 61,822 (1986).

[14] *See Ozark Gas Transmission Co.*, 68 FERC ¶ 61,032 at 61,107-108 (1994) (business and financial risk determine where the pipeline should be placed within the zone of reasonableness); *Williston Basin Interstate Pipeline Co.*, 67 FERC ¶ 61,137 at 61,360 (1994) ("Bad debts are a risk of doing business that is compensated through the pipeline's rate of return").

[15] Project-financed pipelines are projects in which the lender secures its loans to the pipeline by the service agreements negotiated with the contract shippers. *See Kern River Gas Transmission Co.*, 50 FERC ¶ 61,069 at 61,145 (1990).

> requirements from initial shippers before committing funds to the construction project.[[16]]

The Commission further stated that[17]:

> The termination of an existing shipper's service is abandonment under the Natural Gas Act,[[18]] and, accordingly, it is important to ensure that collateral requirements do not unnecessarily cause the termination of a shipper's service. The collateral requirement asked of existing shippers whose credit status has fallen below the pipeline's credit standards must be reasonable and directly related to the risks faced by the pipeline. In many if not most cases, the existing shipper is continuing to pay for service under its contracts even though its credit status has been lowered, and that shipper should not be pressed into default by overly onerous collateral requirements.
>
> For existing shippers under contract, the Commission generally finds that its traditional policy of requiring no more than the equivalent of three months' worth of reservation charges reasonably balances the shippers' right to continued service with the pipelines' risk. Three months corresponds to the length of time it takes a pipeline to terminate a shipper in default and be in a position to remarket the capacity. Three months also is an appropriate measure of the

---

[16] *Calpine Energy Services, L.P. v. Southern Natural Gas Co.*, 103 FERC ¶ 61,273, *reh'g denied*, 105 FERC ¶ 61,033 (2003) (30 months' worth of reservation charges found to be reasonable for an expansion project); *North Baja Pipeline, LLC*, 102 FERC ¶ 61,239 at P 15 (2003) (approving 12 months' worth of reservation charges as collateral for initial shippers on new pipeline); *Maritimes & Northeast Pipeline, L.L.C.*, 87 FERC ¶ 61,061 at 61,263 (1999) (12 months prepayment); *Alliance Pipeline L.P.*, 84 FERC ¶ 61,239 at 62,214 (1998); *Kern River Gas Transmission Co.*, 64 FERC ¶ 61,049 at 61,428 (1993) (stringent creditworthiness requirements required by lenders); *Mojave Pipeline Co.*, 58 FERC ¶ 61,097 at 61,352 (1992) (creditworthiness provisions required by lender); *Northern Border Pipeline Co.*, 51 FERC ¶ 61,261 at 61,769 (1990) (12 months' worth of collateral for new project).

[17] *Id.* at P 13-14.

[18] *American Gas Ass'n v. FERC*, 912 F.2d 1496, 1516-18 (D.C. Cir., 1990).

> pipeline's current remarketing risk. The amount of collateral advanced by a shipper under an existing contract does not directly reduce the current risk faced by the pipeline. When a shipper's credit rating has declined so that it is no longer creditworthy under the pipeline's tariff, the pipeline faces a risk no matter what the collateral requirement. If the shipper defaults, the pipeline is faced with remarketing the capacity. Similarly, if the shipper cannot meet a higher collateral requirement, and is terminated for that reason, the pipeline also would be faced with remarketing the capacity.[[19]] Further, requiring more collateral will increase the current risk of default from a shipper that cannot provide such expensive collateral.[[20]]

9. In the policy statement, the Commission also addressed other issues that are pertinent to the issues raised in this proceeding. The Commission stated[21] that it would "consider on a case-by-case basis any pipeline proposal to take into account a shipper's credit status in determining whether more than three months collateral can be required when shippers are bidding for available capacity on the pipeline's existing system." The Commission continued that "[a] shipper's credit status may be a relevant factor in assessing the value of its bid as compared with bids by more creditworthy shippers, and in determining the amount of collateral that a non-creditworthy shipper must provide to have its bid considered on an equivalent basis."[22]

<u>The May 3, 2006 Order</u>

10. In order to give North Baja and GTN a further opportunity to explain their positions and to provide the Commission additional information so that it can further address the issues raised in this proceeding, the May 3, 2006 Order directed North Baja and GTN to file a brief to address, based on the specifics facts and circumstances of those

---

[19] Certainly, if the shipper could put up more collateral, the pipeline would be better protected for a potential future default, since it would have a longer period to try to remarket the capacity. But such a potential future benefit does not change the current remarketing risk to the pipeline.

[20] See PG&E Gas Transmission, Northwest Corporation, 105 FERC ¶ 61,382, at P 18-28 (2003).

[21] Id. P 15.

[22] Id.

two pipelines, why the Commission should approve a 12 month collateral requirement for non-creditworthy shippers as opposed to the Commission's general policy of three months of collateral.

11. In addition to addressing the general issue discussed above, North Baja and GTN were directed to address the following specific issues:

> (1) Describe the specific facts and circumstances that make GTN and North Baja different from all other pipelines;
>
> (2) With respect to North Baja, describe the material facts in dispute that would require an evidentiary hearing requiring the evaluation of witness testimony and demeanor as opposed to a paper hearing;
>
> (3) Explain and provide evidence as to whether these pipelines face any unusual credit risk and explain why this credit risk should not be considered a business risk that the pipelines are compensated for in their rates of return;
>
> (4) Explain why a three month collateral requirement for existing shippers is not an adequate measure of GTN's and North Baja's remarketing risk and why the Commission should authorize abandonment for an existing shipper that fails to post 12 months of collateral; and
>
> (5) Explain whether the ability, pursuant to the policy statement, to file for a mechanism under which the pipelines can take into account a shipper's credit status in allocating available capacity among competing bidders would protect the pipelines against unnecessary credit risk.

12. The pipelines were also required to provide the following:

(1) For each of the prior three calendar years, a schedule for each pipeline that depicts (a) the extent to which each pipeline has been fully subscribed on a firm basis, (b) availability of firm capacity by date, and (c) for each posting of available capacity, the date new contracts were signed.

(2) Information for all shipper defaults within the past ten years: amount of capacity subject to the default, the duration of the contract, the shipper's rate relative to the maximum rate, and whether the shipper's contract was an initial contract as part of an expansion and whether it was subject to construction-related collateral requirements.

(3) For each such default in Q2, indicate the length of time until the capacity was resubscribed, the duration of the new contract, and the rate relative to the maximum rate for each such resubscription.

13. GTN and North Baja were directed to file their brief within 30 days of the date of the order. Parties to the above-captioned proceedings were permitted to file comments within 30 days after GTN and North Baja file their brief. On June 2, 2006, GTN and North Baja filed a brief on voluntary remand. Comments were filed by the Process Gas Consumers Group (PGC), Sierra Pacific Power Company (Sierra Pacific), and Coral Energy Resources, L.P. (Coral).

The Brief of GTN and North Baja

14. GTN and North Baja argue that the NGA does not require that pipelines provide service to non-creditworthy shippers and, as such, a twelve-month collateral requirement for such shippers is by definition just and reasonable. GTN and North Baja argue that because the Commission has approved tariff provisions on other pipelines (Kern River, Mojave, and Northwest) that do not provide any alternatives, any alternatives a pipeline elects to offer non-creditworthy shippers are necessarily just and reasonable.

15. GTN and North Baja argue that the rationale underlying the Commission's decision to allow greater collateral requirements for expansion shippers applies with even greater force to shippers served by existing capacity. GTN and North Baja argue that simply because the pipeline has already expended the construction costs does not mean that its financial risk of cost of recovery has disappeared. They assert that just as a pipeline has the right to protect its investment in new facilities, a pipeline has the right to an opportunity to recover the costs of existing facilities. GTN and North Baja contend that to the extent the Commission limits collateral when service is performed using existing facilities the Commission jeopardizes this legally-required opportunity. GTN and North Baja submit that blind application of the three months policy to existing capacity will also shift significant financial risk from other segments of the energy industry to the interstate transporters. GTN and North Baja assert that a more stringent collateral requirement for shippers willing to commit to a pipeline's initial capacity or any newly constructed expansion capacity, but a lesser requirement for shippers that bide their time and wait for the pipeline to be constructed, discourages shippers from contracting for initial and expansion capacity.

16. GTN and North Baja state that North Baja is a relatively new, greenfield pipeline with a total of five firm customers, none of which is creditworthy. They state that North Baja does not connect to any production area, nor to any market area; rather, it is sandwiched between El Paso Natural Gas, on one side, and Gasoducto Bajanorte, a Mexican pipeline, on the other. GTN and North Baja state that North Baja was

constructed primarily to serve electric generation facilities located in Mexico. GTN and North Baja assert that in the event of default by any one of these shippers, it is unclear whether any other entity will be willing to subscribe for the capacity. They state that North Baja has already suffered one default and has been unable to remarket this capacity. GTN and North Baja assert that a default by one of North Baja's remaining five shippers would have a devastating effect on its financial profile. GTN and North Baja assert that they are unaware of any other pipeline that (1) does not have a single creditworthy shipper; (2) is not directly tied to either a production basin or market area; and (3) is not anchored by an affiliated shipper. They contend that these features distinguish North Baja from most, if not all, other pipelines, and thus justify North Baja's twelve month collateral requirement.

17. GTN and North Baja assert that the specific facts of GTN's system demonstrate that GTN faces a greater credit risk than most, if not all, other pipelines. First, they assert that GTN has a documented and factual history of defaults. GTN and North Baja state that GTN has suffered six bankruptcies on its system over the last five years. They assert that GTN has had more than 525,000 Dth of long term firm capacity returned to the system as a result of shipper defaults. Second, GTN and North Baja assert that GTN's existing firm shippers have a poor credit profile and it has decline precipitously since 1995. They assert that as of June 1, 2006, non-creditworthy shippers held 32 percent of GTN's subscribed capacity. Third, GTN and North Baja assert that shipper credit quality is one of the worst among U.S. pipelines. Finally, they assert that GTN's current market conditions make it very difficult for GTN to remarket capacity on a long-term firm basis. GTN and North Baja assert that the value of GTN's capacity is dependent on the market's outlook of the difference between the anticipated cost of gas from GTN's major supply source, the Western Canadian Sedimentary Basin (WCSB) and the anticipated price of gas in GTN's major market area, California. GTN and North Baja contend that indications are that the gas supply from the WCSB has peaked, and there is already more takeaway pipeline capacity than production from the basin, including ample capacity to deliver gas to Midwestern and Eastern United States markets.

18. North Baja states that this case stems from the Commission's exercise of its authority under section 5 of the NGA to require North Baja to modify its approved tariff. North Baja asserts that as a legal matter, the Commission may not do so without first finding that North Baja's existing tariff was unjust and unreasonable. North Baja states that it must be provided an opportunity to address the evidence proffered by the Commission and to offer evidence supporting the appropriateness of its current practice. North Baja states that a paper hearing can accomplish this objective if evidence is adduced and addressed in a rigorous manner.

19. GTN and North Baja state that a pipeline's risk profile must be reflected in its rate of return. However, GTN and North Baja contend that there are numerous reasons why and adjustment to return on equity, standing alone, is inadequate to protect interstate pipelines that choose to serve shippers that are not creditworthy and to protect creditworthy shippers served by those pipelines. GTN and North Baja assert that return on equity is a cost-of-service item that is borne by all system users, creditworthy as well as non-creditworthy. GTN and North Baja contend that to the extent that system rates reflect costs or revenue shortfalls caused by non-creditworthy shippers, creditworthy shippers must underwrite those costs. GTN and North Baja contend that cost-of-service treatment is a rate-setting method to recover from the users of the systems costs anticipated to be incurred by the system in its operations. They assert that the collateral sought by GTN and North Baja, by contrast, is a device to control, contain or confine those costs. GTN and North Baja argue that collateral does not focus on the actual incurrence of those costs as much as on their avoidance and minimization. GTN and North Baja assert that to expand the ROE function as contemplated by Question 3 of the Commission's order enlarges the scope of inquiry to the financial integrity of the entities being served by the company whose rates are being regulated. GTN and North Baja contend that such an unwarranted expansion would greatly and unduly complicate the ROE issue. GTN and North Baja assert that parties opposing the pipeline's requested change will perhaps argue that shipper defaults are not the type of event that can be foreseen with confidence called for by the "known and measurable" standard. GTN and North Baja argue that should a pipeline reflect a shipper default in the pipeline's based period, parties opposing the requested rates will likely contend that the default is an event that is "nonrecurring."

20. GTN and North Baja contend that even if a pipeline successfully suspends and terminates a contract for non-payment, calling upon three months of collateral only reimburses the pipeline for the first three months of unpaid amounts. GTN and North Baja argue that three months of collateral does not cover the total three and one-half months of non-payment exposure and certainly provides no compensation for remarketing risk. GTN and North Baja submit that the most significant risk a pipeline faces from a shipper default is remarketing risk, which takes into account the period of time necessary to remarket capacity formerly under contract to a defaulting shipper. GTN and North Baja assert that the Commission must recognize that a three month collateral requirement does not contemplate remarketing risk. GTN and North Baja argue that under that collateral requirement, GTN and North Baja are required to provide service to even those that may be exceptionally risky enterprises. GTN and North Baja assert that even a twelve-month collateral requirement provides only eight and on-half months coverage for remarketing risk.

21. GTN and North Baja assert that abandonment of an existing shipper's contract when the shipper fails to post twelve months of collateral should be authorized because there is no legal basis for compelling a pipeline to serve non-creditworthy shippers in the first instance. GTN and North Baja argue that in the modern era of open access transportation by interstate pipelines, the Commission and courts have viewed Section 7(b) of the NGA as protection against the exercise of monopoly power by pipelines. GTN and North Baja assert that because the collateral required by GTN and North Baja of non-creditworthy shippers is not an exercise of pipeline market power, the policy of section 7(b) of the NGA, as it has been construed in the open access era, is not implicated. Therefore, GTN and North Baja assert that the Commission should not exert section 7(b) power over these transactions. They assert that the Commission should permit GTN and North Baja to terminate service to non-creditworthy shippers that do not elect to provide the twelve months of collateral.

22. GTN and North Baja appreciate the Commission's willingness to consider allowing pipelines to take a shipper's credit status into account in awarding capacity. GTN and North Baja state that this will help pipelines improve their overall credit portfolio, and both GTN and North Baja intend to take advantage of this proposal. While the ability to factor a prospective shipper's credit status into the bidding process will be a useful tool, GTN and North Baja contend that it does not dispense with a pipeline's ability to secure adequate collateral from shippers whose credit rating has deteriorated to where non-payment and default become serious threats. They argue that considering a shipper's credit status is a just and reasonable step in the capacity allocation process and should be permitted. However, GTN and North Baja argue that standing alone it will not protect against unnecessary credit risk.

23. GTN and North Baja assert that a twelve-month collateral requirement will not lead to an industry-wide liquidity crisis. GTN states that it has historically required twelve months from non-creditworthy shippers and is aware of no liquidity crisis stemming from this practice. GTN and North Baja contend that liquidity on a pipeline is a function of market conditions, not pipeline credit standards. GTN and North Baja argue that pipeline collateral requirements (even at twelve months) are only a small portion of the collateral that industry participants are required to provide on a day-to-day basis in order to do business. GTN and North Baja submit that to suggest that this small piece of the overall industry puzzle would somehow drive industry liquidity issues is disingenuous.

24. GTN and North Baja assert that a twelve-month collateral requirement will prevent capacity speculation. GTN and North Baja argue that allowing a non-creditworthy shipper to acquire pipeline capacity by merely providing three months of collateral – whether or not that entity has any assets or even a sustainable business plan –

can lead to situations where a shipper acquires capacity on speculation. GTN and North Baja assert that should the value of the capacity drop at some point in the future, even the distant future, the speculating shipper merely walks away. They argue that, having few or no assets, the speculator dose not fear any legal action by the pipeline. GTN and North Baja argue that a three month collateral requirement is an utterly insufficient deterrent to prevent a shipper from unilaterally abrogating its contract in this circumstance, leaving the pipeline and its remaining shippers to sort out issues related to the resubscription of capacity. GTN and North Baja contend that in these cases of capacity speculators with neither valuable assets, secure gas supply, confirmed markets, nor cash flow, even one year of collateral is inadequate protection.

25. GTN asserts that its status as a debt-financed pipeline supports a twelve-month collateral requirement. GTN and North Baja assert that insufficient collateral will choke off GTN and North Baja's access to capital markets. GTN states that it has retuned to the capital markets four times in recent years. GTN asserts that in each case the lenders offering capital to GTN have had only one source of revenues on which they can depend for repayment of their loans: GTN's shipper contracts. Given that recently as much as 50 percent of the net present value of GTN's contracts is no longer backed by any creditworthy entity, GTN argues that it has become critical that GTN retain strong alternative collateral requirements. GTN states that just as in *Gulfstream,*[23] a twelve-month letter of credit requirement will assist GTN in providing its lender the needed degree of certainty that it will be able to maintain this stream of revenues.

26. GTN asserts that the fact that its competitors have twelve-month collateral requirements supports the same requirement for GTN. GTN states that the Commission has approved a pipeline's use of a twelve-month alternative collateral standard on the basis that the pipeline's competitor had a similar standard.[24] GTN states that given that the Commission has found it just and reasonable for both Northern Border and Alliance, two of GTN's major competitors, to require twelve month alternative, a similar provision also should be just and reasonable for GTN. GTN also asserts that the Commission should be further aware that some of the other interstate pipelines serving GTN's core market areas in the Pacific Northwest and California – Kern River, Mojave, Northwest, and Transwestern – have flexible standards within their FERC-approved tariffs and are not limited to three months of alternative collateral.

---

[23] Gulfstream Natural Gas System, L.L.C., 94 FERC ¶ 61,185 at 61,638 (2001).

[24] *Alliance Pipeline, L.P.,* 84 FERC ¶ 61,239 at 62,214-15 (1998)(granting Alliance authority to use a twelve month alternative collateral standard in light of Northern Border, a competitor, having such authority).

Reply Comments

27. PGC asserts that GTN's brief is an impermissible collateral attack on the Commission's policy statement. PGC submits that as a threshold matter, the majority of GTN's brief is devoted to arguing that the Commission's general limitation on collateral of three months worth of service charges is an unsupported policy. PGC asserts that GTN's brief leaves it unsure whether GTN wishes to request a waiver from the general three month limit on collateral outlined in the policy statement or to change the Commission's existing policy.

28. PGC states that GTN complains that because it is unable to offer competitive pipeline service as a general matter, it is unable to successfully remarket capacity that becomes available due to shipper defaults. PGC contends that PGC's non-creditworthy shippers should not be asked to subsidize GTN or compensate the pipeline for its inability to attract new shippers. PGC argues that the question of how ratepayers and shareholders share the costs associated with these types of general capacity contracting and remarketing issues should be determined in GTN's general section 4 rate case. PGC asserts that it is possible that no amount of collateral would cure GTN's fundamental capacity re-contracting problems. PGC contends that GTN's remedy to increase the credit requirements for non-creditworthy shippers will not make GTN more competitive since it will be likely that its existing non-creditworthy shippers will be unable to afford the new credit requirements.

29. PGC states that on June 30, 2006, GTN filed a new general section 4 rate case where it requested a rate of return on equity (ROE) of 14.5 percent and proposed to nearly double its currently effective firm transportation rates. PGC argues that these extraordinarily large proposed increases in GTN's ROE and transportation rates should provide GTN with more than enough protection from the risks associated with doing business with non-creditworthy shippers, and the section 4 rate case will provide a forum to vet these issues. PGC submits that the new rate case will give GTN the opportunity to address its general contract and remarketing concerns with all of its ratepayers.

30. PGC states that it is true that GTN has had the misfortune of contracting for capacity with Enron and certain segments of the industry that have fallen on hard times. PGC states that to make matters worse these bankrupt entities are large capacity holders on GTN. Nonetheless, PGC asserts that GTN's situation in this regard does not demonstrate systemic problems that require a deviation from the Commission's general creditworthiness policies. PGC submits that in no case do GTN's unfortunate circumstances warrant a change to the Commission's general policy limiting shipper collateral to three months of service charges. PGC argues that GTN's real problems – its inability to attract shippers – should be addressed in the context of its new section 4 rate case.

31. Coral asserts that GTN's and North Baja's specific facts and circumstances do not justify imposition of creditworthiness standards beyond that set forth in the Policy Statement. Coral asserts that it is not difficult for any pipeline to distinguish itself in some way from the bulk of other pipelines. Coral states that North Baja's business plan from day one was to ship gas north to south to serve power plants in Mexico and later reverse flow to move LNG from south to north. Coral states that virtually all pipelines regardless of their size, have credit issues with some shippers, and even a large pipeline with a diverse customer base can be harmed by shipper defaults. Coral asserts that regardless of its size, North Baja has provided no evidence that it would be at risk of failure if one of its current five shippers were to default.

32. Coral argues that North Baja may be less risky than many pipelines because it is not particularly susceptible to supply or market failures. Coral states that North Baja's current source of supply is El Paso Natural Gas Company and its current markets include several state of the art gas fired generating stations that are destined to provide base load generation for decades. Coral states that after North Baja reverse its flow as proposed in Docket No. CP06-61-000, its primary supply source will be the only LNG terminal on the West Coast, backstopped by supply agreements with Shell, ChevronTexaco, ConocoPhillips, and Woodside Energy. Coral states that the shippers of regasified LNG will be creditworthy entities such as Coral, Sempra, FPL Energy, Chevron, ConocoPhillips and Woodside. Coral submits that North Baja will serve California or east of California markets that continue to thirst for new sources of natural gas. Coral contends that if there were problems with LNG supply, North Baja remains connected to El Paso. In addition, Coral argues that the government of Mexico has a significant interest in assuring that gas continues to flow of North Baja, further assuring payment by the shippers.

33. Coral argues that GTN has not demonstrated that it is significantly different from other pipelines. Coral states that GTN has been in business for many years and moves gas from a major supply basin to large growing markets, including PG&E and other large local distribution companies and electric utilities. Coral states that PG&E alone accounts for 26 percent of long-term firm capacity on the pipeline. Coral states that Western Canadian reserves continue to be productive and recoverable reserves remain in the thirty year range. Coral states that when new pipeline projects move Rocky Mountain supplies to east in competition with Canadian gas moving east through Northern Border and Alliance, moving gas to California may offer better netback prices to Canadian producers, increasing the need for transportation on GTN. Coral argues that the need for transportation is a function of steady or growing markets. Coral asserts that the Pacific Northwest has few transportation options and GTN is the biggest pipeline in the region. Coral contends that GTN has not shown that its apparent assumption (as reflected in the Calpine bankruptcy)-- that its capacity affected by a particular shipper's failure will go

entirely unused for the remaining term (23 years in the case of Calpine) of a transportation agreement—is valid. Coral argues that contrary to its claims, GTN's shippers largely meet its creditworthy specifications. Shippers include LDCs such as PG&E as well as major energy companies or their affiliates which have worldwide assets and strong credit ratings.

34. Coral states that GTN has a financial indifference provision in section 28.1 of the GT&C of its tariff that permits it to require long term replacement shippers to provide far more than 12 months of credit support when the prior shipper either was more creditworthy or provided multiple years of security to support an expansion project. Coral states that these provisions permit pipelines to require additional credit support regardless of the replacement shipper's credit rating. For example, Coral (whose parent has an A2 rating) recently replaced a shipper on GTN with a BBB rating. Despite Coral's higher credit rating and the fact that Coral would otherwise be considered creditworthy under GTN's tariff (since its rating is better than BBB-), GTN required Coral to post tens of millions of dollars of security in the form of a parental guarantee and a non-revocable letter of credit to support the long term firm transportation agreements that Coral was assuming. Coral asserts that if GTN has treated other shippers similarly to Coral, GTN's overall credit support profile should reflect credit in far excess of security for many of the shippers GTN claims place it at risk. Coral argues that the Commission should be aware that there may be other relevant information that GTN has not included with regard to credit support of its shippers.

35. Coral argues that GTN and North Baja should address the issue of the relative risk in rate cases. In fact, Coral submits GTN filed a section 4 general rate case that included both a request for credit support that is inconsistent with the Policy Statement and a request for a 14.5 percent rate of return on equity. Coral states that GTN's Statement P testimony indicates that the proposed 14.5 percent return on equity is based in part on the business risk GTN faces. Coral contends that GTN should not be permitted to have it both ways, *i.e.*, both a higher rate of return and a greater level of credit support beyond what other pipelines are permitted to require from customers. Coral argues that GTN's rate case filing calls into question GTN's argument in its brief that credit risk should not be addressed by rate of return. Coral asserts that the credit issues of GTN and North Baja should not be laid at the feet of Coral or any other shippers on these pipelines. Each shipper's creditworthiness must stand on its own; it is not driven by the pipelines' financial or rate status.

36. Sierra Pacific asserts that GTN has failed to address, much less challenge, its own demonstration that based on GTN's own risk assessment, no more than a three month collateral for existing shippers that are public utilities is appropriate. Sierra states that GTN initiated this proceeding by submitting a tariff filing that required all existing non-

creditworthy shippers to provide one year's collateral for firm service, and then subsequently acknowledged that its actual intent was to confer itself with authority to impose collateral of one year or less, and that its policy was to impose only three months collateral for public utilities. Sierra submits that GTN continued this practice in the present remand phase of this proceeding by filing a brief that argues for one year collateral for existing non-creditworthy shippers, without mentioning its historic custom and current policy of requiring only three months of collateral for such customers that are public utilities. Sierra contends that GTN's own actions confirm what is in any event required by Commission precedents and regulations – that GTN be directed to set forth explicitly in its tariff that it will impose no more than three months of reservation charges for existing non-creditworthy shippers that are public utilities.

Discussion

37. The issue in this proceeding is whether GTN and North Baja should be permitted to collect 12 months of collateral from existing shippers whose credit has been downgraded rather than the 3 months of collateral that has been general Commission policy for a number of years. In the case of North Baja, the Commission found pursuant to section 5 of the Natural Gas Act that its tariff provision requiring 12 months of collateral was unjust and unreasonable. With respect to GTN, the Commission rejected its proposal to require 12 months of collateral for non-creditworthy shippers finding that such a requirement was excessive and not in conformance with the Commission's general policy.

38. As discussed below, after considering the entire record in this case, the Commission reaffirms its finding that GTN and North Baja should not be permitted to collect more than three months collateral from shippers.

Commission Credit Policy Justifies The General Three-Month Collateral Requirement

39. The Commission's historic policy on creditworthiness was designed to ensure all shippers had equal access to service without unreasonable barriers to entry that would inhibit the development of a national grid and access to competitively priced supplies. As reflected in the Policy Statement, because pipelines are regulated utilities with market power, the Commission strives to establish credit and collateral policies that balance the interests of the pipeline in receiving adequate security while protecting shippers against unduly harsh collateral requirements and ensuring that pipeline service is reasonably available on an open access basis. Maintaining such a balance is particularly important with respect to the collateral requirements imposed on existing shippers of the pipeline

because termination of service to such shippers constitutes abandonment of service.[25] GTN and North Baja, therefore, are not correct in arguing that in an open access environment, they have no obligation to continue to serve non-creditworthy customers. Unless the Commission grants abandonment of service, the service obligation continues even in an open access environment.[26]

40. In balancing the interests of shippers and pipelines, the Commission developed its policies to address the risks posed in different situations. With respect to contracts leading to new construction, the Commission has recognized that pipelines and their lenders can have a reasonable basis for requiring relatively large collateral requirements for non-creditworthy shippers in order to justify committing funds to the construction project.[27] Indeed, all of North Baja's initial service contracts fall within this category.

41. The Commission has further recognized that in selling available service to new shippers that pipelines have a reasonable interest in obtaining the highest value for their capacity and that, in recognition of that interest, should be able to take a shipper's credit into account in evaluating bids for capacity.[28] The Commission has therefore provided

---

[25] *American Gas Ass'n v. FERC*, 912 F.2d 1496, 1516-18 (D.C. Cir. 1990) (finding that termination of a contract even at the expiration of its term constitutes abandonment of service).

[26] 18 C.F.R. § 154.602 requires that the pipeline provide the Commission with 30 days advance notice of the termination of an executed service agreement.

[27] *Calpine Energy Services, L.P. v. Southern Natural Gas Co.*, 103 FERC ¶ 61,273, *reh'g denied*, 105 FERC ¶ 61,033 (2003) (30 months' worth of reservation charges found to be reasonable for an expansion project); *North Baja Pipeline, LLC*, 102 FERC ¶ 61,239 at P 15 (2003) (approving 12 months' worth of reservation charges as collateral for initial shippers on new pipeline); *Maritimes & Northeast Pipeline, L.L.C.*, 87 FERC ¶ 61,061, at p. 61,263 (1999) (12 months prepayment); *Alliance Pipeline L.P.*, 84 FERC ¶ 61,239 at p. 62,214 (1998); *Kern River Gas Transmission Co.*, 64 FERC ¶ 61,049, at p. 61,428 (1993) (stringent creditworthiness requirements required by lenders); *Mojave Pipeline Co.*, 58 FERC ¶ 61,097, at p. 61,352 (1992) (creditworthiness provisions required by lender); *Northern Border Pipeline Co.*, 51 FERC ¶ 61,261, at p. 61,769 (1990) (12 months' worth of collateral for new project).

[28] *See American* Gas *Ass'n*, 912 F.2d 1496, 1517 (value measured by willingness to pay generally used for allocations); *Tennessee Gas Pipeline Co.*, 76 FERC ¶ 61,101, at p. 61,518 (1996) (accepting net present value formula for allocating capacity), *aff'd*, *Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002) (affirming no

(continued)

the pipelines with an opportunity to develop a reasonable, non-discriminatory method for taking credit into account.[29] GTN in its latest rate case has, in fact, advanced such a proposal.[30]

42. The major issue raised by GTN and North Baja is with the Commission's rejection of their proposals to charge 12 months collateral requirement to existing shippers whose credit rating has been reduced, and limiting such collateral to three months. Because the termination of service is abandonment under the Natural Gas Act, the Commission needs to ensure that pipeline tariff requirements do not unreasonably and unnecessarily result in the abandonment of service to a shipper. The collateral requirement asked of existing shippers whose credit status has fallen below the pipeline's credit standards must be reasonable and directly related to the risks faced by the pipeline.

43. The 12 month collateral proposals at issue here do not meet that standard. The proposals by both GTN and North Baja would result in an the existing shipper, which has not defaulted and is continuing to pay for service under its contracts, to put up 12 months collateral or risk termination, simply because its credit status has been lowered.[31]

44. Imposing such a 12-month collateral requirement does not appreciably reduce the pipeline's remarketing risk. As explained in the December 24, 2003 Order in the GTN proceeding,[32]

---

length of contract cap for NPV bids); *Texas Eastern Transmission Corp*., 79 FERC ¶ 61,258 (1997), *aff'd on rehearing*, 80 FERC ¶ 61,270 (1997) (use of net present value to allocate capacity), *aff'd*, *Municipal Defense Group v. FERC*, 170 F.3d 197 (D.C. Cir. 1999) (finding use of NPV allocation method not unduly discriminatory when applied to small customers seeking to expand service).

[29] Policy Statement, at P 15.

[30] *Gas Transmission Northwest Corporation*, 116 FERC ¶ 61,109 at P 14 (2006)

[31] *See Tennessee Gas Pipeline Co. v. FERC*, 400 F.3d 23, 27 (D.C. Cir. 2005) (shipper's contractual breach may consist only of the failure to post collateral due to a change in its creditworthiness evaluation).

[32] 105 FERC ¶ 61,382, at P 25.

> Certainly, if the shipper could cobble together the twelve-months of collateral proposed by GTN,[33] GTN would be better protected for a potential future default, since it would have a longer period to try to remarket the capacity. But such a potential future benefit does not change GTN's current remarketing risk. If the shipper defaults, GTN is subject to the risk of remarketing the capacity. Further, requiring twelve months of collateral will increase the current risk of default from a shipper that cannot provide such expensive collateral. In short, although the Commission recognizes the need for greater collateral for initial shippers on new construction projects, it has determined that in balancing the interests of the pipeline and subsequent shippers on existing facilities, the potential benefit to the pipeline of longer collateral requirements for service on existing facilities is not sufficient to offset the harm to shippers and to the principle of open access service from having shippers required to provide larger collateral.

45. Since the amount of collateral required of a shipper whose credit rating has been reduced does not significantly affect the pipeline's risk of having to remarket the capacity, the Commission reiterates that its traditional policy of requiring no more than the equivalent of three months' worth of reservation charges reasonably balances a shipper's interest in continuing service with the pipeline's risk of potential loss from a default. The three months corresponds approximately with the time period it would take a pipeline to seek to terminate or abandon service and be in a position to remarket the capacity.

46. For these reasons, the Commission generally finds unreasonable the imposition on a shipper that is continuing to pay its bills of the collateral requirements advocated by GTN and North Baja, which could be so onerous as to press the shipper into default and abandonment of service. The Commission would not find it reasonable to grant service abandonment to a pipeline with respect to a shipper that has continued to meet its obligations simply because its credit rating has been reduced. As a result, the Commission does not find it generally reasonable to accept a 12-month collateral requirement for such a shipper, since a failure to meet that collateral requirement could itself result in a request for termination of service and abandonment. In these circumstances, the Commission's three-month collateral requirement policy more reasonably balances the interests of the pipeline and an existing shipper.

---

[33] Even a one-year prepayment could not guarantee recovery of costs of facilities with service lives of 30-50 years.

GTN and North Baja Have Not Justified Different Treatment

47. The primary argument presented by GTN and North Baja is that the specific facts and circumstances of their pipelines make them unlike other pipeline systems in the United States and that they face unusual credit risk that warrants twelve months of collateral for non-creditworthy shippers.

48. Shippers should not face significantly different credit policies on different portions of an integrated pipeline grid. Instead, the Commission has taken into account credit risk as an element to be considered in determining a pipeline's rate of return. In *Ozark*,[34] the Commission found that Ozark had an increased risk that justified a higher rate of return, among other things, because of the risk that its major customer was in bankruptcy and might reject its contract. But determining whether credit risk justifies a higher rate of return depends not only on the credit risk of current customers, but other factors such as the extent of excess capacity and the ability to remarket capacity.

49. GTN and North Baja argue that being compensated through the rate of return is not enough to protect them when they serve non-creditworthy shippers and 12 months of collateral is also needed. GTN and North Baja assert that a collateral requirement is a way to confine costs. They further argue that credit risk is not appropriately addressed within the issue of rate of return.

50. Such arguments are contradicted by GTN's own testimony in its RP06-407-000 rate case where they are seeking a 14.5 percent rate of return because of increased business and financial risks. As reflected in the testimony of GTN's witnesses, credit risk, along with other factors, should be considered be considered in evaluating rate of return. GTN's rate of return witness Moul based his analysis in part on GTN's witnesses Ferron-Jones and Levine. Ex. GTN-48 at 19. In describing GTN's commercial environment, Witness Ferron-Jones stated "GTN is unable to sell its long-term firm capacity because the market simply does not require it. As such, unsubscribed capacity is often valued by the market at less than zero. In addition, the credit quality of GTN shippers has deteriorated, which means that fewer shippers are capable of purchasing firm capacity." Ex. GTN-26 at 3. In addition, Witness Levine's testimony states:

---

[34] *Ozark Gas Transmission Co.*, 68 FERC ¶ 61,032 at 61,107-108 (1994). *See Williston Basin Interstate Pipeline Co.*, 67 FERC ¶ 61,137 at 61,360 (1994) ("Bad debts are a risk of doing business that is compensated through the pipeline's rate of return").

> **Q:** **<u>Are there other factors that the Commission should consider in evaluating a pipeline's business risk?</u>**
>
> **A:** Yes. The Commission should also consider the strength of the pipeline's contractual status. For example, a pipeline that is fully subscribed with long-term firm contracts will tend to have low business risk due to the resulting cash flow stability. Another factor is the credit quality of the shipper's that hold a pipeline's capacity. In general, a pipeline with high credit quality shippers has a lower risk than a pipeline with lower credit quality shippers because the latter faces higher exposure to shipper defaults or bankruptcy (which can adversely affect the pipeline's cash flows). Ex. GTN-42 at 6.

Witness Levine went on to state that:

> The credit quality of a pipeline's shippers is another factor to consider in evaluating the risk position of a pipeline. Pipelines with low credit quality shippers are more exposed to shipper bankruptcies. In fact, GTN currently is facing exposure as a result of Calpine's bankruptcy. Calpine holds roughly 160,000 Dth/d of GTN's capacity, and has indicated its intent to repudiate roughly 75,000 Dth/d of that capacity (from Kingsgate to Malin). GTN Witness Kenneth Nichols describes how a large amount of GTN' firm contracted capacity is held by shippers that are not creditworthy, which suggest significant contractual risk for GTN, despite the contract expiration profile that is shown in Figure 8. Ex. GTN-42 at 47.

51. Thus, in its rate case, GTN has recognized that credit risk needs to be examined in the light of other factors to determine an appropriate rate of return. If North Baja believes that it is facing increased business and financial risk because of market, supply, contractual profile, and credit issues, it also is free to seek an increased rate of return in a section 4 rate filing as was proposed by GTN in its filing.

52. In any event, after considering the other factors cited by GTN and North Baja, the Commission finds that these factors do not establish that Gas Transmission Northwest's and North Baja's proposed larger collateral requirements are just and reasonable.

53. With respect to GTN, the Commission recognizes that it has had a number of shipper defaults over the past few years. However, these defaults are isolated and appear to be related to or a result of an unusual event, the western energy crisis. On Exhibit 12, which lists shipper defaults from 1996 through 2006, there are 12 defaults by four different companies (Enron, Newport Northwest, Mirant Americas, and Calpine). These

defaults occurred in 2002 and 2004. The Calpine contracts were identified as repudiated contracts in the bankruptcy court. It should also be noted that Calpine retained a number of contracts as well. These were the only defaults occurring in a ten year period. In addition, despite such defaults, Exhibit No. 11 shows that as of April 2006 GTN is 89 percent subscribed for long term firm capacity.

54. With respect to North Baja, although it claims it is in a tenuous position because it has five non-creditworthy shippers, it has had only one default, which occurred in 2002, and as of April 2006 it is 95 percent subscribed for long term firm capacity. Moreover, virtually all of North Baja's current shippers participated in its construction, and the twelve month collateral requirement established for these shippers remain fully in place.[35]

55. GTN and North Baja also argue that they need twelve months of collateral because they face unusual remarketing risk. GTN claims that there are poor transportation market fundamentals between its Western Canadian supply basin and its California market area. North Baja asserts that it is not directly tied to either a production basin or market area and is not anchored by an affiliated shipper. North Baja states that it was unable to remarket the capacity of its one defaulting shipper and goes on to speculate that it would be unlikely to be able to remarket capacity of any future defaulting shipper. Nevertheless, in Docket Nos. CP06-61-000 and CP01-23-003 North Baja seeks certificate authorization to more than quadruple delivery capacity, and has firm service precedent agreements for approximately 2.4 Bcf/d.[36]

56. If, as GTN and North Baja assert, they face deficiencies in their gas supplies or market profiles or both, such an issue would not be solved by requiring 12 months of collateral from non-creditworthy shippers. As GTN itself recognizes, "GTN is caught between suppliers with better options to sell gas and markets with better options to buy gas. . . . These poor transportation market fundamentals are expected to continue for several years."[37] As stated above, this is also a factor that can be considered in determining the appropriate rate of return for each pipeline. In fact, GTN recognized as much in its section 4 rate case filing in Docket No. RP06-407-000 filed on June 30, 2006, where it requested a return on equity of 14.5 percent to reflect "the increased business

---

[35] *See North Baja*, 105 FERC ¶ 61,374, at P 15, 18-19 (clarifying that North Baja's collateral requirements for its expansion shippers are not affected by the requirement to remove the three-month collateral requirement from its tariff).

[36] *North Baja Pipeline, LLC*, 117 FERC ¶ 61,022 (2006).

[37] Ex. No. GTN-26 at 3 in Docket No. RP06-407-000.

and financial risks GTN now faces." GTN's Docket No. RP06-407-000 Letter of Transmittal at 4.

57. In addition, there is a question as to whether the situation is a serious as GTN and North Baja claim. As Coral pointed out, North Baja is not susceptible to supply or market failures because North Baja's current source of supply is El Paso Natural Gas Company, a major intestate pipeline, and its current markets include several state of the art gas-fired generating stations that are destined to provide base-load generation for decades. Moreover, as Coral points out with respect to GTN, GTN moves gas from a major supply basin, the Western Canadian Sedimentary Basin, with productive and recoverable reserves in the thirty year range to steady or growing markets in the Pacific Northwest and Northern California. The Pacific Northwest has few transportation options and GTN is the biggest pipeline in the region. We agree with Coral that GTN has failed to show that northern California markets will not be steady or continue to grow over time, regardless of the isolated bankruptcies of a handful of shippers. As Coral points out, the Pacific Gas and Electric Company (PG&E) alone accounts for 26 percent of long-term firm capacity on the pipeline. Nevertheless, if the situation is as described by GTN and North Baja, the appropriate way of reflecting these types of business risks are through the rate of return in a section 4 rate case**.** The Commission recognizes that the policy established in prior creditworthiness orders indicated that a pipeline's individual circumstances could be taken into account in determining whether that pipeline could vary from the general policy of 3 months of collateral for non-creditworthy existing shippers. We have considered GTN's and North Baja's individual circumstances, and we have determined that they do not merit requiring 12 months of collateral for non-creditworthy existing shippers. We also now find that the type of long-term business risks cited by GTN and North Baja are best addressed through the rate of return in a section 4 rate case.

58. GTN and North Baja argue it is within their discretion in all circumstances to decline to serve non-creditworthy shippers and therefore any mechanism they put into place to allow non-creditworthy shippers to continue service is just and reasonable. As discussed earlier, GTN and North Baja are incorrect in asserting they can establish any collateral policy they wish for shippers with contracts. The failure to put up required collateral can lead to termination, hence abandonment of service. The Commission must determine whether such a termination is in the public convenience and necessity. Moreover, the Commission is responsible for establishing just and reasonable terms and conditions of service. As the Commission recognized in the Policy Statement, it has been the Commission policy for nearly 20 years to permit pipelines to require up to three months of collateral from non-creditworthy shippers in order to ensure that open access transportation service is reasonably available. But, for the reasons discussed earlier,

requiring 12 months collateral is not reasonable for an existing shipper that is continuing to pay its monthly charges.

59. GTN and North Baja cite to *Tennessee Gas Pipeline Co.* [38] for the proposition that the Commission permits pipelines to refuse service to non-creditworthy shippers. The case, however, does not justify such an interpretation. In *Tennessee*, the Commission rejected a proposed provision by Tennessee that would have permitted Tennessee to discontinue service to any shipper who fails to demonstrate creditworthiness. The Commission recognized, as we have here, that the pipeline cannot unilaterally abandon service.

> In *Transco* and *Texas Eastern*, we held that a pipeline cannot simply abandon service to a shipper that fails to demonstrate creditworthiness without specific authorization to terminate service. Our holding in those cases is applicable here as well. Accordingly, Tennessee is required to file revisions to its tariff consistent with this determination. Although we have not permitted termination of blanket certificate transportation without authorization, we have permitted prepayments for service in circumstances where the shipper has failed to demonstrate creditworthiness.[39]

This language does not suggest, as GTN and North Baja, maintain that the pipeline is free to discontinue service to a non-creditworthy shipper and that the pipeline has discretion as to the length of collateral to be required. Rather, the Commission was stating that the pipeline cannot discontinue service, but that it would be reasonable for the pipeline to require some form of collateral or pre-payment. In fact, the Commission then went on to indicate that six months collateral would be too long, but that three months collateral would be reasonable: "In *Northern Natural Gas Co*., we rejected a provision that required a prepayment equal to the cost of providing the service for six months as being unreasonably long and determined that three months' prepayment would be an adequate security deposit."[40]

---

[38] 40 FERC ¶ 61194 (1987)

[39] *Id*. at 61,635-36.

[40] *Id*. *See Northern Natural Gas Co.*, 37 FERC ¶ 61,272, at 61,822 (1986).

60. GTN and North Baja also point to several currently effective tariffs that it claims provide pipelines discretion in serving shippers and do not contain alternatives such as a letter of credit or prepayment as evidence that whatever collateral requirements it provides are necessarily just and reasonable. As the Commission found in its December 24, 2003 Order,[41] GTN and North Baja have not cited to Commission orders as being at odds with the policy adopted here. Because GTN/North Baja did not cite to specific orders, it is unclear under what circumstances the provisions at issue were accepted. For example, in the absence of protests, the Commission may simply have accepted these provisions without examining whether they conformed to Commission policy and precedent.[42] Under such circumstances, accepting another pipeline's provisions does not necessarily establish a generic Commission policy or precedent regarding similar tariff provisions.

61. The Commission has the ability to proceed either through case-by-case adjudication or rulemaking.[43] In the Policy Statement, the Commission determined that given industry changes, it was not necessary to proceed with a rulemaking, but that it could address credit questions on a case-by-case basis.[44] Here, a complaint was filed against GTN, and GTN subsequently made a section 4 rate case filing. Similarly, the question with respect to North Baja's tariff came up during the course of an ongoing proceeding. In these circumstances, the Commission could act on the basis of the filings based on its current precedent and policy, without necessarily taking action with respect to other pipelines in which complaints have not been raised with respect to existing tariff provisions. Moreover, the tariffs cited by GTN and North Baja still allow non-creditworthy shippers to receive service under certain circumstances.

62. GTN and North Baja argue that the twelve month collateral requirement would prevent capacity speculation. They provide no support for such a position and merely provide a hypothetical situation of a shipper that is not financially sound taking advantage of a three month collateral requirement to speculate on transportation capacity and then defaulting when it is no longer economically advantageous to hold such capacity. Again, if these are the types of business risk faced by GTN and North Baja,

---

[41] 105 FERC ¶ 61,382, at P 20.

[42] *See Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) (agency can change policy as long as it supplies a reasoned analysis).

[43] *See Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985);

[44] Policy Statement FERC Stats. & Regs. ¶ 31,191 at P 6.

they are adequately addressed by the rate of return. Moreover, this issue is also addressed by the Commission's invitation to pipelines to propose mechanisms to take into account credit status when allocating available capacity. Such a mechanism would help prevent any such speculation and GTN and North Baja indicate that they will propose such mechanisms. In fact, GTN has proposed such a mechanism in its rate case in Docket No. RP06-407-000.

63. The Commission finds that GTN and North Baja's argument that a 12 month collateral requirement will not cause an industry-wide liquidity crisis is irrelevant. While parties may have argued such in these proceedings, the Commission did not use liquidity as basis for requiring three months of collateral. The Commission is concerned with providing shippers access to pipeline transportation capacity at reasonable terms.

64. GTN argues that it is different from other pipelines because it is debt-financed and should be treated the same as project-financed pipelines with longer collateral requirements. The Commission previously rejected this argument in its December 24, 2003 Order finding that GTN had not supported its contention that its lenders currently require longer than three months collateral.[45] GTN has not presented any new arguments on this issue. The Commission has found that with respect to new construction, particularly project-financed pipelines, pipelines and their lenders could require larger collateral requirements from initial shippers before committing funds to the construction project. The collateral requirements would be set forth in the relevant precedent agreements. Further, the *Gulfstream*[46] case cited by GTN is not applicable here because that was a case granting a certificate that stands for the policy of allowing larger collateral requirements for initial shippers on new construction or expansion. GTN can avail itself of those protections for new construction or expansion but cannot use that policy for existing or new shippers.

65. We find no merit to North Baja's claim that it was not given an appropriate hearing under section 5 of the NGA. GTN and North Baja have had a full opportunity to explain the facts and circumstances of their systems that believe justify a 12 month collateral requirement. We have considered everything in the record, which was sufficient to enable us to consider and rule on all the issues in this case.

---

[45] PG&E Gas Transmission, Northwest Corporation, 105 FERC ¶ 61,382 at P 48 (2003).

[46] Gulfstream Natural Gas System, L.L.C., 94 FERC ¶ 61,185 at 61,638 (2001).

66. In conclusion, under Commission policy, GTN and North Baja have the opportunity file a rate case that examines whether their pipelines are sufficiently risky that an adjustment in rate of return is necessary. A rate case is the appropriate vehicle to examine risk and the distinctions between these and other pipelines, which GTN and North Baja assert. In fact, GTN has already filed a rate case seeking a higher rate of return for precisely these reasons. Neither GTN nor North Baja has presented any support to show that any differences between their and other pipeline systems justify the significant deviation from standard Commission creditworthiness policy that they have requested. Moreover, there are a number of mechanisms such as higher collateral requirements for construction projects and lateral line capacity, taking into account credit status in allocating capacity to adequately protect the interests of GTN and North Baja while still providing reasonable conditions for non-creditworthy shippers to obtain open access transportation.

The Commission orders:

GTN's and North Baja's request to find 12 months of collateral for non-creditworthy shippers just and reasonable is denied.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.