103 FERC ¶ 61,273

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Calpine Energy Services, L.P. — Docket No. RP03-312-000

v.

Southern Natural Gas Company

ORDER DENYING COMPLAINT

(Issued June 4, 2003)

1. On March 26, 2003, Calpine Energy Services, L.P. (Calpine) filed a complaint against Southern Natural Gas Company (Sonat). The complaint alleges that Sonat is imposing excessive collateral requirements on Calpine with respect to the construction of its South System II Expansion Project (Expansion Project).[1] Calpine contends that such a collateral requirement is in violation of the express terms of its Service Agreement, Sonat's tariff, and Commission policy. Calpine also argues that the Commission should, among other things, find that Sonat is not justified in continuing to require that Calpine provide collateral in excess of three months of demand charges.

2. In this order, the Commission denies Calpine's complaint, finding that Sonat's level of collateral does not violate its Service Agreement, Sonat's tariff, or the Commission's policy. Moreover, Calpine agreed to the level of collateral and operated under these conditions for two years before making its complaint. Accordingly, the Commission finds that Sonat's collateral requirement is not unreasonable and finds that there is no basis to undo an agreement under which the parties have operated.

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[1] See Southern Natural Gas Co., 100 FERC ¶ 61,281 (2002).

I. Background

3. Sonat conducted an open season from December 15, 2000 to January 26, 2001, in order to solicit requests for new transportation service in connection with its Expansion Project.[2] Initially, eight shippers subscribed to the Expansion Project, and each of the service agreements specified an initial term of 15 years. Four of the eight shippers were found to be creditworthy, and another four, including Calpine, were found to be non-creditworthy. Each of the four non-creditworthy shippers were to provide Sonat with collateral equal to 30 months of demand charges.

4. On April 20, 2001, Calpine signed a Service Agreement under Rate Schedule FT (hereinafter, Service Agreement) which reflected its open season bid for 135,000 Mcf/day of firm capacity. However, Calpine states that Sonat refused to countersign the Service Agreement unless Calpine provided $45 million in collateral, which was approximately equal to 30 months of Calpine's projected demand charges. Calpine further states that when it attempted to negotiate a reduction in the collateral requirement, Sonat would not negotiate. Instead, Sonat responded that it would plan to move forward with designing the Expansion Project without consideration of Calpine's facilities.[3]

5. Calpine states that since it believed the Expansion Project would be the only viable means of transporting gas to its future power plants, it had no other choice but to submit to Sonat's demands. Therefore, on July 12, 2001, Calpine provided $45 million in collateral assurance in the form of a $35 million surety bond and a $10 million guarantee from Calpine's parent company.

6. On July 31, 2001, Calpine executed an Service Agreement for a reduced amount of capacity on the Expansion Project (95,000 Mcf/day). In response, Sonat reduced Calpine's collateral requirement to $31 million, an amount equal to 30 months of demand charges at this reduced capacity level. Calpine states that it reduced the amount of the surety bond to $21 million and left the $10 million guarantee in place.

7. On April 24, 2002, at Calpine's request, the parties executed an amended agreement which further reduced Calpine's capacity commitment to 65,000 Mcf/day, and

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[2]The Expansion Projected anticipated the construction of approximately 65,000 horsepower of compression, 114 miles of large diameter loop, and related facilities at an original cost of $240 million. The size of the project required completion in two phases, with Phase I placed in service by June 1, 2003, and Phase II by May 1, 2004.

[3]Complaint at Attachment F.

the Service Agreement was revised accordingly. However, Sonat did not permit a corresponding reduction in the surety bond because Sonat considered the parental guarantee to be worthless in light of credit downgrades experienced by the parent company. Sonat therefore required that Calpine maintain the $21 million surety bond to secure the 30 months of demand charges associated with 65,000 Mcf of capacity. Having determined that the $10 million parental guarantee "would not have any value in the foreseeable future," Sonat states that it recently released the guarantee to Calpine.[4]

II. Calpine's Position

8. Calpine alleges that Sonat's requirement that non-creditworthy shippers provide 30 months of demand charges as collateral is excessive and in violation of the express terms of its Service Agreement, Sonat's tariff, and Commission policy.

9. Calpine states that its participation in the Expansion Project is not governed by a precedent agreement during the construction period. Rather, it states that its Service Agreement is the primary document that governs the rights and obligations of the parties, including those related to credit assurances.

10. Calpine contends that Paragraph 2.1 of Article II of the Service Agreement incorporates by reference, and states that the Service Agreement is subject to all provisions contained within the General Terms and Conditions (GT&C) of Sonat's tariff. Further, Calpine points out that Article V of the Service Agreement states: "Unless otherwise agreed to by the parties, the terms of Rate Schedule FT and/or [the GT&C] shall apply to the construction of any facilities necessary to effectuate the [Service Agreement]." Calpine asserts that there has been no agreement to deviate from the tariff's requirements on any matter, including creditworthiness.

11. In support of its argument, Calpine asserts that Section 2.1(d) of Sonat's GT&C establishes a cap equal to three months of transportation charges on the amount of collateral that Sonat can require from any non-creditworthy shipper.[5] Calpine reasons,

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[4]Answer at P 25.

[5]Section 2.1(d), in pertinent part, states:

> COMPANY shall not be required to perform services . . . for any SHIPPER who is or has become insolvent, or who fails to demonstrate creditworthiness . . . provided, however, such SHIPPER may receive service if SHIPPER makes a

(continued...)

since the Service Agreement incorporates the GT&C by reference, Sonat cannot require Calpine to provide collateral greater than three months of demand charges.

12. Calpine also believes that GT&C Section 15.4, concerning payment defaults, also supports the three-month cap. Section 15.4 states that:

> Upon default in payment for a period in excess of twenty (20) days, COMPANY may require as a condition to the continuation or recommencement of transportation services a deposit or other acceptable credit arrangement in an amount equal to not more than three estimated maximum monthly bills for transportation services.

13. Moreover, Calpine asserts that the parole evidence rule, as applied in Commission precedent, bars Sonat from imposing any credit requirement beyond those that are expressed within the Service Agreement.[6] Calpine points out that, consistent with this proposition, Paragraph 8.3 of the Service Agreement expressly provides that any amendment must be in writing and executed by the parties.[7] Calpine concludes that there is no evidence that Sonat and Calpine ever intended to deviate from Sonat's generally applicable three-month collateral requirement.

14. Calpine also argues that the existing collateral requirement violates Commission policy. Calpine states that the Commission has established that a maximum of three months of prepayments can be required from non-creditworthy shippers, except in special

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[5](...continued)
security deposit in an amount equal to the cost of performing the maximum transportation service requested by SHIPPER for a three (3) month period, furnishes good and sufficient surety, as determined by COMPANY in its reasonable discretion, in an amount equal to the cost of performing the maximum transportation service requested by SHIPPER for a three (3) month period, or furnishes a guaranty from a creditworthy party that said creditworthy party will be responsible for payment of all charges and penalties assessed by COMPANY but not paid by SHIPPER.

[6]Citing Pacific Gas & Elec. Co., 96 FERC ¶ 63,043 at 65,290 (2001), aff'd, 97 FERC ¶ 61,082 (2001); see also Niagara Mohawk Power Corp., 46 FERC ¶ 61,016 (1989), and Cinergy Services, Inc., 94 FERC ¶ 61,146 (2001).

[7]Calpine maintains that the Surety Bond cannot be construed as such an amendment because it was not executed by Sonat. Rather, it was executed by Calpine and the issuer of the surety bond, with Sonat as the obligee.

circumstances involving project-financed pipelines.[8] Calpine believes that even in special circumstances, maximum prepayments may increase only to 12 months of charges.[9] Calpine also notes that in North Baja Pipeline, LLC,[10] the Commission held that when undertaking a major system expansion or constructing a greenfield project, a pipeline may require up to 12 months of security from its initial subscribers at the time the project is certificated, but once service commences, additional shippers should be subject to no longer than a three-month prepayment. Calpine cites North Baja to support its contention that it should have to provide no more than three months of collateral assurance.

15. Calpine therefore asserts that only during the construction phase of a project-financed expansion, would Commission policy allow a pipeline to request collateral in an amount up to 12 months of demand charges. Calpine, however, concludes that since the Expansion Project is not project-financed, Commission policy permits only a three month requirement during both the construction and in-service phase of the project.

16. Finally, Calpine argues that the current level of required collateral assurance bears no relationship to the low financial risk of the project to Sonat. To support this charge, Calpine maintains that, in the project's certificate proceeding, Sonat estimated the project would earn a $151 million profit over its first 15 years, and that Sonat received Commission approval to roll the costs of the project into its system rates in its next general rate filing since the project will benefit all of its shippers in the capacity-constrained area served by Sonat's system. Calpine also believes that allowing Sonat to reduce its financial risk through unnecessarily high collateral assurances will enable Sonat to continue to engage in what Calpine characterizes as improvident lending practices with its parent company, currently under Commission scrutiny.[11]

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[8]Citing Florida Gas Transmission Co., 66 FERC ¶ 61,140 (1994); and 66 FERC ¶ 61,376 (1994).

[9]Calpine also notes that in Tennessee Gas Pipeline Co., 102 FERC ¶ 61,075 (2003), the Commission permitted collateral prepayments up to the cost of minor facilities only during construction.

[10]102 FERC ¶ 61,239 (2003) (North Baja).

[11]Citing the response of the El Paso Corp. to the Commission's inquiry in Docket Nos. FA02-36-000 and IN02-6-000.

III. Sonat's Response

17. Sonat states that the amount of collateral requested from Calpine is both lawful and reasonable. Sonat believes that it is under no obligation to construct facilities for any shipper, citing that the courts have already determined that the decision of a pipeline to expand its facilities is left to the judgment of the stockholders and directors of the individual pipelines.[12] Sonat argues that its complete discretion in this regard is preserved in Section 1(b) of its Rate Schedule FT.[13] As such, Sonat states that a shipper and the pipeline must reach a mutual agreement on the terms and conditions that will apply to the construction of facilities.

18. Sonat contends that notwithstanding Section 1(b) of its Rate Schedule FT, it offered four non-creditworthy shippers, including Calpine, the opportunity to join the Expansion Project if they provided the requested amount of collateral. In this case, Sonat determined that a reasonable collateral security would be an amount equal to the shipper's monthly reservation charge times thirty.

19. While Calpine argues that its request for new transportation service is governed by Section 2.1(d) of Sonat's GT&C, Sonat responds by explaining that Section 2.1 is only applicable to requests for transportation service utilizing existing facilities. Sonat states that the express terms of Section 2.1(d) refer only to its obligation to perform a service and a shipper's right to receive a service and that this Section is silent with respect to the construction of facilities.

20. In order to provide the service that Calpine requested, Sonat states that it would have to invest over $92 million in new facilities. In this case, Sonat explains that its determination of the level of collateral depends on a number of factors, such as the size and nature of the project and the business and economic conditions at the time. For this project, Sonat listed the following factors as increasing the risk of the project: the project was heavily dominated by the non-creditworthy shippers, which increased the probability

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[12] Citing Panhandle Eastern Pipeline Co. v. FPC, 204 F.2d 675, 680 (3rd Cir. 1953).

[13] Section 1(b) provides: COMPANY shall not be obligated to construct, modify, or acquire facilities to perform transportation services under this Rate Schedule except that COMPANY shall construct and install facilities necessary to deliver gas directly to an end user if SHIPPER meets the requirements set out in Section 36 of the General Terms and Conditions. In the event that COMPANY determines that it will construct facilities that will result in the expansion of its pipeline system, COMPANY shall offer the proposed expansion capacity to all shippers on a non-discriminatory basis.

that the project might experience a failure of performance at some point; the non-creditworthy shippers were all involved in merchant power generation plants; some of the requesting parties were special purpose entities, and their projects did not have established and secure markets; and the general power market was becoming overbuilt. For these reasons, Sonat claimed that the prudent business would be inclined to move its assessment of the appropriate amount of collateral security farther along the continuum towards an amount equal to the cost of the facilities.

21. On the other hand, Sonat found that although there were uncertainties associated with the non-creditworthy shippers' business ventures and the market for power, the fact that the projects consisted of the addition of facilities along an existing main line and not a greenfield pipeline into a new service area, decreased the possibility that the new capacity would remain unused for extended periods if any of the expansion shippers failed to perform their service agreements. Based on these considerations, Sonat found that given the large amount of capacity that was being added to the system, thirty months seemed like a reasonable period of time in which to remarket the capacity.

22. Sonat also highlights the fact that Calpine voluntarily agreed to provide Sonat with the requested collateral security in the July 31, 2001 Service Agreement. Sonat argues that Calpine should not now be permitted to abrogate its commitments over a year and a half after the contract was signed. Sonat states that if Calpine had any misgivings about either the legality or propriety of Sonat's request, the time to raise them was when the request was made in Spring 2001, not two years later after Sonat has expended millions of dollars in reliance on Calpine's commitment.

23. Moreover, Sonat argues that the relief sought by Calpine is beyond the Commission's power to grant. Citing the Mobile-Sierra doctrine, Sonat states that the Commission can only interfere with the rights and obligations of private contracting parties under circumstances where it seeks to advance the public interest.[14] Sonat states that only Calpine's interest, and not the public interest, would be advanced if the Commission were to abrogate Calpine's contractual commitment to provide the requested collateral security.

24. Ultimately, Sonat argues that Calpine is seeking Commission relief from a commitment it voluntarily undertook to provide a reasonable level of collateral security in conjunction with its participation in the Expansion Project. Sonat contends that the collateral that Calpine agreed to is not inconsistent with the Service Agreement or

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[14]Citing United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) (Mobile). FPC v. Sierra Power Co., 350 U.S. 248 (1956) (Sierra).

Commission policy. Accordingly, Sonat believes that Calpine has failed to state a claim justifying any relief and that its complaint should be dismissed.

IV. Notice of Filing and Interventions

25. Notice of Calpine's complaint was issued on April 3, 2003, with interventions, protests and comments due on or before April 10, 2003.[15] Duke Energy Trading and Marketing, L.L.C., and Duke Energy Fuel, L.P.; Georgia Industrial Group (GIG); Interstate Natural Gas Association of America; North Baja Pipeline, LLC (North Baja); South Carolina Pipeline Corp.; and Southern Company Services, Inc. filed timely motions to intervene. GIG and North Baja also filed comments.

26. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[16] all timely filed motions to intervene are granted.

V. Comments

27. In its comments, North Baja states that the Commission should recognize that pipelines have no obligation to expand their systems and will only do so to the extent they believe the expansion comports with their internal risk profiles. North Baja states that allowing pipelines the discretion to establish credit requirements tailored to specific expansion proposals will further the Commission's goal of promoting pipeline infrastructure development.

28. GIG comments that shippers should have notice as to the scope of a pipeline's credit requirements, and is concerned by Calpine's allegations that Sonat has not given advance notice of the credit requirements that it is attempting to impose on Calpine. GIG also states that it is concerned with the allegation that Sonat is attempting to impermissibly deviate from the credit requirements that are in its tariff.

VI. Discussion

29. The Commission finds that the level of collateral requested by Sonat does not violate the Service Agreement, Sonat's tariff, or Commission policy. Accordingly, for the reasons discussed below, the Commission finds no compelling reason to reduce Calpine's collateral from thirty to three months of demand charges.

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[15] 68 Fed. Reg. 16,275.

[16] 18 C.F.R. § 385.214 (2003).

30. The Commission does not find that Sonat's collateral requirement is unjust and unreasonable or in violation of Commission policy. It is well established that Section 7 of the Natural Gas Act does not obligate pipelines to build new facilities for shippers.[17] If pipelines are prevented from requiring collateral sufficient to protect their investments in new capacity requested by shippers, the result may be that pipelines decide not to construct needed facilities, or that the cost of capital for the pipeline itself would increase, raising rates to other shippers.

31. In addition, pipeline mainline expansions can be exceedingly expensive and pipelines cannot be expected to commit funds to such expansions on behalf of non-creditworthy shippers without adequate collateral protection. As recently explained in PG&E Gas Transmission, Northwest Corp., a pipeline undertaking a system expansion may require larger amounts of collateral from non-creditworthy shippers than from shippers on existing facilities, since the pipeline is entitled to ensure, prior to investing significant resources in the expansion, that it will have a reasonable possibility of protecting its investment from the impact of a subsequent shipper default.[18] Further, having its investment protected by reasonable collateral requirements benefits not only the pipeline, but the pipeline's other shippers whose future rates might be impacted by such default. In short, the pipeline should not be required to serve as a partial guarantor of the shipper by constructing the facilities without such protection.[19] However, as Sonat recognizes, the risk of a mainline expansion to the pipeline, and consequently the need for collateral, can be minimized when such expansions increase the overall capacity of the pipeline, and to the extent the pipeline is able to remarket that capacity in the event of a shipper default.[20]

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[17]Panhandle Eastern Pipe Line Co. v. FERC, 204 F.2d 675 (3rd Cir. 1953); Panhandle Eastern Pipe Line Co., 91 FERC ¶ 61,037, at 61,141-42 (2000).

[18]103 FERC ¶ 61,137 at P 33 (2003) (GTN).

[19]However, once the construction costs have been incurred and the pipeline is in service, new shippers that take service on existing facilities cannot legitimately be subjected to the same collateral requirement as the shippers upon whose credit the construction was financed. Once pipeline facilities are constructed, the major risk to the pipeline is the potential loss of reservation charges associated with the contract termination process. The Commission’s established three-month collateral requirement provides the pipelines with sufficient protection against this risk.

[20]With respect to interconnection and lateral facilities, the Commission permits the
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32. In this case, the Commission cannot find that the 30-month collateral requirement required by Sonat is an unreasonable sharing of the risks associated with this expansion project. In addition, non-creditworthy shippers represented a significant portion of the overall project and some of the requesting parties were special purpose entities, whose projects did not have established and secure markets. Further, all of the non-creditworthy shippers agreed to the collateral requirements, and Calpine itself operated under these conditions for two years, raising the issue only after the construction is virtually complete. Given these circumstances, Sonat's collateral requirement cannot be found to be unreasonably related to the risks it faced, and the Commission finds no basis to undo the agreement on which the parties have operated.[21]

33. The Commission also has the authority to review any such collateral requirements to ensure that they are imposed in a not unduly discriminatory manner. In this case, Sonat treated all its non-creditworthy shippers similarly. Since Sonat is not requiring its shippers to post an unreasonable level of collateral, and has not unduly discriminated against Calpine, we find that its existing collateral requirement is reasonable and does not violate Commission policy.[22]

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[20](...continued)
pipeline to request collateral up to the full cost of the facilities. See, e.g., Natural Gas Pipeline Co. of America, 102 FERC ¶ 61,355 at P 80-85 (2003). But interconnection or lateral line facilities generally are built to serve one or a relatively few potential shippers, so the pipeline will have far less ability to remarket those facilities than for mainline facilities.

[21]Issues relating to creditworthiness requirements and collateral for mainline construction projects are best addressed in the certificate proceeding prior to the pipeline's commitment of resources to the project, not after the pipeline has already obtained financing and commenced building the project based on the collateral agreements into which the parties have entered.

[22]In the event of default and termination, the pipeline will be required to reduce the collateral it retains by mitigating damages. Pipelines are required to post capacity for sale after a termination. One method of mitigation would be for the pipeline to determine its damages by taking the difference between the highest net present value bid for the capacity and the net present value of the remaining terms of the shipper's contract. The pipeline could then retain as much of the collateral as necessary to cover the damages. Pipelines could also develop alternative measures for determining mitigation.

34. Calpine claims that requiring security greater than 12 months is at odds with our decision in North Baja.[23] In North Baja, the pipeline requested 12 months of collateral, and the Commission found that "requiring twelve months of security may be acceptable in the precedent agreements leading up to the issuance of a certificate."[24] While our language may have been unclear, we did not intend to establish a policy that security for pipeline expansions cannot exceed 12 months of service charges. As discussed above, the Commission finds that Sonat's 30-month collateral requirement is not unreasonable in the circumstances here.

35. Calpine argues that notwithstanding Commission policy, the Service Agreement between it and Sonat, through its incorporation of Sonat's GT&C, limits the collateral to three months of demand charges. However, the parties here do not dispute that Sonat required the payment of the collateral from Calpine, as well as from other shippers, as a condition of its signing the Service agreement.[25] Indeed, Calpine acknowledges that Sonat refused to countersign its Service Agreement until the required collateral was received.[26] There is ample evidence to indicate that Calpine clearly understood Sonat's collateral requirements and initiated the necessary arrangements to obtain the required collateral.

36. The evidence that has been presented by both parties makes clear that since July 12, 2001, Calpine has continuously posted collateral in an amount approximately equal to 30 months worth of demand charges, which reflects its understanding that such collateral was required by the parties' agreement. If Calpine has always believed that this required level of collateral violates the Service Agreement and Sonat's GT&C, Calpine could have brought this matter to the Commission or to a court at a much earlier stage, rather than waiting almost two years to file a complaint. Thus, having determined that Calpine and Sonat reached an agreement as to the required level of collateral before the Service Agreement was executed was satisfied, the Commission need not reach Calpine's arguments regarding specific provisions in the Service Agreement and the GT&C.

37. In light of the conduct of the parties discussed above, we do not find that the Service Agreement's incorporation by reference of the entirety of Sonat's tariff, including

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[23] 102 FERC ¶ 61,239 (2003) (North Baja).

[24] North Baja at P 15.

[25] The Commission recognizes that Sonat has applied its collateral requirement in a nondiscriminatory manner against all four non-creditworthy shippers.

[26] Complaint at P 7.

Section 2.1(d), establishes that the parties intended to agree to a three month collateral requirement. The tariff is intended to determine the obligations of the parties after service has begun, and should not determine the parties' obligations with respect to construction.[27] Section 2.1(d) does not expressly state that it is intended to apply to collateral for construction projects, and is sufficiently ambiguous that the Commission needs to examine the parties' actions in drafting the contract to discern their intent.[28] Given the clear evidence showing that the longer collateral requirement was a condition precedent to the signing of the Service Agreement, the Commission finds that the incorporation by reference of Section 2.1(d) does not reflect the parties intent and should not govern the collateral requirements for the construction project. The Commission, therefore, finds no basis to now undo an agreement that the parties have been honoring since July 2001.[29]

38. In light of the foregoing, the Commission finds no basis to provide Calpine with the relief it requests in its complaint, and accordingly, the complaint is dismissed.

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[27]As the Commission stated in North Baja, collateral requirements and other conditions relating to construction of new facilities should be reflected in precedent agreements, not in the pipeline's tariff which applies only after the facilities are in service. North Baja at P 15 (2003).

[28]See Cajun Electric Power Cooperative, Inc. v. FERC, 924 F.2d 1132 (D.C. Cir. 1991) (reversing Commission for not examining proffered evidence of parties' intent in drafting contract).

[29]In order to avoid such controversy in the future, the Commission strongly encourages Sonat to include in a precedent agreement, or other agreement, any collateral requirements.

The Commission orders:

Calpine's complaint is hereby dismissed, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.