

143 FERC ¶ 61,238  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Philip D. Moeller, John R. Norris,  
Cheryl A. LaFleur, and Tony Clark.

Kern River Gas Transmission Company      Docket No. RP12-250-001

ORDER DENYING REHEARING AND REQUIRING TARIFF CHANGES  
PURSUANT TO SECTION 5 OF THE NATURAL GAS ACT

(Issued June 18, 2013)

1. This proceeding has its origin in 2009 when Kern River Gas Transmission Company (Kern River) filed to revise its creditworthiness provisions, which are set forth in section 29 of the General Terms and Conditions (GT&C) of its tariff.<sup>1</sup> The filing resulted in a number of Commission orders that resolved most, but not all of the issues. The remaining unresolved issue is the security Kern River can require from a non-creditworthy shipper to continue to receive service.

2. The Commission's general policy as explained in the Commission's Policy Statement on Creditworthiness (Policy Statement)<sup>2</sup> has been to permit pipelines to require shippers that fail to meet the pipeline's creditworthiness requirement to put up collateral equal to three months' worth of reservation charges to continue to receive service. The Policy Statement noted, at P 13, that 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. The Commission has also recognized that in cases of new construction, particularly project-financed pipelines, which are projects in which the lender secures its loans to the pipeline by the service agreements negotiated with the

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<sup>1</sup> See, e.g., *Kern River Gas Transmission Co.*, 127 FERC ¶ 61,103 (2009) (May 2009 Order); *Kern River Gas Transmission Co.*, 131 FERC ¶ 61,060 (2010) (April 2010 Order).

<sup>2</sup> *Policy Statement on Creditworthiness for Interstate Natural Gas Pipelines and Order Withdrawing Rulemaking Proceeding*, FERC Stats. & Regs. ¶ 31,191, at P 11 (2005) (Policy Statement).

contract shippers, the pipelines and their lenders could require larger collateral requirements from initial shippers before committing funds to the construction project. Kern River is such a project-financed pipeline.

3. In a series of orders the Commission ultimately held that because certain of Kern River's lending documents so provided, Kern River could require 12-months collateral, rather than Commission policy of three months of collateral, for non-creditworthy shippers to continue to receive service. In the most recent order<sup>3</sup> the Commission stated "we do not find that any future refinanced or new debt will serve to extend the date upon which the 12-month collateral requirement for existing or new firm shippers will apply. At the expiration of Kern River's debt as it existed on August 12, 2010, Kern River will no longer be able to require collateral of 12 months' reservation charges from existing or new firm shippers but must adhere to the Commission's policy applicable to all pipelines of no more than 3 months' collateral."<sup>4</sup>

4. Kern River was directed to file revised tariff records to clarify the limitation on its 12-month collateral requirement, or explain why it should not be required to do so. In response, Kern River filed for rehearing, and a response why it should not be required to change its tariff, and therefore, Kern River did not revise its tariff. For the reasons set forth below, the Commission denies rehearing, and requires Kern River to revise its tariff to make clear that the 12-month collateral requirement for non-creditworthy shippers to continue to receive service will end at the expiration of Kern River's debt that existed on August 12, 2010.

## **I. Background**

### **A. 2009 Section 5 Proceeding in Docket No. RP09-466**

5. Kern River is a project-financed pipeline. At the time of Kern River's 2009 filing Kern River stated its existing capacity had been financed by \$510 million series A notes issued for the original system, and \$836 million series B notes issued for the purpose of financing Kern River's 2003 expansion. Kern River stated that the series A and B notes are scheduled to be paid off in 2016 and 2018 respectively. In addition, Kern River indicated that it intended to issue a third series of notes to finance its Apex Expansion

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<sup>3</sup> *Kern River Gas Transmission Co.*, 139 FERC ¶ 61,221 (2012) (June 2012 Order).

<sup>4</sup> *Id.* P 45.

that would be subject to the same set of lending documents, and the new notes would not be scheduled to expire for approximately 20 years.<sup>5</sup>

6. In the 2009 filing Kern River continued the provisions in GT&C section 29.2(b) that in order to continue service to a shipper that had become non-creditworthy the shipper could furnish “other security acceptable to transporter’s lenders.” In response to the protests to the 2009 filing that this provision was vague and contrary to the directives in the Policy Statement, Kern River answered that requiring more than three months’ security was pursuant to its construction financing documents and consistent with Commission policy. The Commission initiated a proceeding under section 5 of the Natural Gas Act (NGA) and required Kern River to show cause that its existing tariff provision is just and reasonable. The order required Kern River “to provide its current loan agreements or other relevant documentation supporting the need for a collateral requirement in excess of three months of reservation charges, or in the alternative, revise its tariff sheets to limit the security requirements applicable to existing capacity to no more than the equivalent of three months of reservation charges.”<sup>6</sup>

7. Kern River submitted its lending documents to support the longer collateral security of twelve months. These documents contained a provision requiring that security provided by new non-creditworthy shippers be equal to one year of reservation charges. After review of these documents, the Commission found that:

Kern River's lending documents warrant an exception to the general policy that pipeline tariffs may not impose on new, non-creditworthy shippers a collateral requirement of more than three months' reservation charges. As the Ozark decision made clear, it is unreasonable for the Commission to expect pipelines to renegotiate their lending agreements to comply with a later-approved Commission policy. Because pipelines and their lending institutions have a reliance interests in the collateral pledged for expansion or construction projects, it is unreasonable for the Commission to question such collateral

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<sup>5</sup> On September 16, 2010, the Commission issued a certificate authorizing the Apex Expansion Subject to Condition, *Kern River Gas Transmission Co.*, 132 FERC ¶ 61,226 (2010). On October 5, 2011, Kern River filed a motion in Docket No. CP10-14-000, that Kern River had commenced service under its Apex Expansion Project.

<sup>6</sup> *Kern River Gas Transmission Co.*, 127 FERC ¶ 61,103, at P 33 (2009).

requirements after financing has been obtained and the project is completed.<sup>7</sup>

8. However, Kern River also had sought to modify its tariff to specifically include in the tariff the 12 month reservation charges requirement. The Commission rejected this proposal as too broad. Rather, to make clear that the 12-month security charge was limited to the term of Kern River's existing lending agreements, the Commission required Kern River to revise its tariff to make clear that the longer collateral requirement applied only to its "current lending documents," and to provide a definition of "current lending documents" in the definitions section of the tariff.<sup>8</sup>

9. In compliance with the order, Kern River modified section 29.2 of its GT&C to state that a non-creditworthy, long-term firm shipper may receive service if it "furnishes security as required by Transporter's current lending documents."<sup>9</sup> Kern River also proposed GT&C definition § 29.2(1.0.0) which stated: "For purposes of this Section 29.2, 'Transporter's Current Lending Documents' means the Trust Indenture dated as of August 13, 2001, among Kern River Funding Corporation, Kern River Gas Transmission Company, as guarantor, and the trustee, as amended and supplemented from time to time." No protests were filed, and the Commission accepted this filing by delegated letter order on August 12, 2010 in Docket No. RP09-466-006.<sup>10</sup>

#### **B. 2011 Filing in Docket No. RP12-250**

10. On December 16, 2011, Kern River filed revised tariff provisions concerning the lender appeal process: how non-creditworthy shippers could seek relief from Kern River's lenders from the 12-month collateral requirement. In a January 13, 2012 order<sup>11</sup>

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<sup>7</sup> *Kern River Gas Transmission Co.*, 131 FERC ¶ 61,271, at P 66 (2010).

<sup>8</sup> *Id.* P 69.

<sup>9</sup> Kern River Gas Transmission Company, Docket No. RP09-466-006 (July 23, 2010).

<sup>10</sup> The Commission also issued orders relating to other aspects of GT&C section 29. See *Kern River Gas Transmission Co.*, 132 FERC ¶ 61,080 (2010) (July 29 Order), *order on reh'g*, 134 FERC ¶ 61,231 (2011) (March 25 Rehearing Order). Those orders will be discussed only to the extent they impact the issue presented here.

<sup>11</sup> *Kern River Gas Transmission Co.*, 138 FERC ¶ 61,024 (2012) (January 2012 Order).

the Commission accepted and suspended Kern River's proposed tariff provisions, subject to Kern River's providing further explanation and support for its proposed lender appeal process. In addition the Commission directed Kern River to:

explain how many of its original lending documents require collateral in excess of three months, and how many of its existing 75 to 100 lenders would need to be contacted should a non-creditworthy shipper seek relief from a collateral requirement imposed by the current lending documents. Kern River must also explain when the original lending documents requiring collateral in excess of three months' reservation charges will expire and whether, in Kern River's view, such documents are subject to change.<sup>12</sup>

11. In a February 13, 2012 filing, Kern River provided additional information pertaining to its lending documents and the lender appeal process. Kern River explained that its current long-term debt is issued pursuant to one set of lending documents that were initiated in 2001, and described its existing and expected debt. Kern River stated that the lending documents have no specified expiration date, and will continue in force and effect until payment and performance in full of all obligations under debt issued pursuant to the documents.

12. Kern River described its lending documents as a set of documents that work together, referencing each other and in most cases subject to each other.<sup>13</sup> Key lending documents include a trust indenture, which Kern River asserts contains the requirement for 12 months of security in the form of either a letter of credit or cash in escrow, collateral agency agreement, credit agreement, and assignment of contracts, pledge and security agreement (which actually assigns the shipper credit support to lenders as collateral).

13. The June 2012 Order accepted Kern River's explanation of the lender appeal process and no change was required in that part of GT&C section 29. However, the order noted that in the compliance filing Kern River stated that it interpreted the past Commission orders and its tariff as allowing it to continue the 12-month collateral

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<sup>12</sup> *Id.* P 34.

<sup>13</sup> February 13, 2012 Filing. at 3-4.

requirement in any *new* debt issued or refinanced by Kern River.<sup>14</sup> The Commission found that this conclusion was unwarranted, stating that “such an understanding, however, is at odds with the Commission's prior orders, its policy, and Kern River's tariff.”<sup>15</sup>

14. The Commission explained that in the prior June 25, 2010 Order, pursuant to section 5 of the NGA, the Commission permitted a 12-month collateral requirement only to the extent that Kern River's existing lending agreements as of August 12, 2010 impose these collateral requirements and remain outstanding. The Commission explained:

The Commission was clear that it was allowing Kern River an exception to its general policy based on the reliance interest of Kern River and its lenders in maintaining the terms of this existing debt. The June 25 Rehearing Order was not an open-ended exemption from the Commission's general creditworthiness and collateral requirements that would apply either to refinancing of existing debt or the issuance of new debt by Kern River, as suggested by Kern River in its compliance filing.<sup>16</sup>

15. The Commission further explained that while Kern River's tariff bases the collateral requirements on the trust indenture “as amended and supplemented from time to time,” it interpreted that clause in light of the Commission’s section 5 requirement as referring to changes to the Trust Indenture related to Kern River's debt as it existed August 12, 2010, not to the addition of future lending documents or the modification of existing lending documents to incorporate new or refinanced debt. The Commission further pointed out that Kern River itself recognized that any reduction in collateral from a non-creditworthy shipper would require a “supplement” to the lending documents. The Commission interpreted the tariff provision “as amended and supplemented from time to time,” as referring to this type of modification, not to the addition of a new lending document. The Commission therefore concluded that interpreting this tariff clause as applying to future or refinanced debt, as Kern River did, would be contrary to the

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<sup>14</sup> *Id.* at 3 (stating that Kern River intends to issue a third series of notes to finance its Apex Expansion subject to the same set of lending documents, which would not be scheduled to expire for approximately 20 years).

<sup>15</sup> June 2012 Order, 139 FERC ¶ 61,221 at P 40.

<sup>16</sup> June 2012 Order, 139 FERC ¶ 61,221 at P 43.

Commission's section 5 orders requiring Kern River to limit the exception only to current lending documents.

16. Moreover, to ensure that the correct interpretation was reflected in the tariff, the Commission acted under section 5 to require Kern River to revise its tariff to remove any ambiguity in this regard, and "to make clear that the 12-month collateral requirement will end when Kern River's debt as it existed on August 12, 2010 ends, or explain why it should not be required to do so."<sup>17</sup>

### **Kern River's Request for Rehearing and Response**

17. Kern River did not revise its tariff but filed a request for rehearing and a response attempting to explain why it should not be required to revise its tariff as directed in the June 2012 order. Kern River stated that the June 2012 Order ignored the fact that Kern River's lending documents will not end when the debt that existed on August 12, 2010 ends. Kern River asserts that the 2001 Trust Indenture does not expire with the repayment of Kern River's debt as it existed on August 12, 2010, but continues to support any future debt that Kern River would issue. Kern River asserts that the Commission previously recognized and approved that the 2001 Trust Indenture, as amended and supplemented from time to time, governs what collateral Kern River may require from non-creditworthy shippers to continue service. Kern River reiterates that the lending documents that govern the security collateral requirements do not expire when the current debt expires, as the June 2012 order presumed, and any subsequent debt would be secured by existing and new long-term firm transportation service agreements under the terms of such lending documents which require the twelve-month collateral requirement.

18. Kern River argues that the June 2012 Order is contrary to prior Commission findings in this proceeding. Those findings acknowledged that (1) Kern River's lending documents warrant an exception from the Commission's three month collateral policy;<sup>18</sup> (2) Kern River and its lenders have a reliance interest in the terms of the lending documents that the Commission will not and should not disturb;<sup>19</sup> (3) the Commission will not question the criteria in such lending documents at this late stage;<sup>20</sup> and (4) it

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<sup>17</sup> *Id.* P 46.

<sup>18</sup> *Kern River Gas Transmission Co.*, 131 FERC ¶ 61,271 at P 66.

<sup>19</sup> *Id.* P 73.

<sup>20</sup> *Id.* P 73.

would not be reasonable to require Kern River and its lenders to have to renegotiate its lending documents to comply with later-established Commission policy.<sup>21</sup>

19. Kern River further contends that the Commission's interpretation of Kern River's tariff is specious. In fact, Kern River argues, the June 2012 Order recognized that the Commission had approved the tariff definition of Transporter's current lending documents as the Trust Indenture dated August 13, 2001, "as amended and supplemented from time to time."<sup>22</sup> Despite this concession, the Commission now asserts that "we interpret that clause as referring to changes to the Trust Indenture related to Kern River's debt as it existed August 12, 2010, not to the addition of future lending documents or the modification of existing lending documents to incorporate new or refinanced debt."<sup>23</sup> Kern River contends that the Commission's prior orders cannot be so understood as the Commission's now claims. Thus, there is no basis for the limitation now required by the June 2012 Order.

20. For the same reasons that Kern River requests rehearing, Kern River asserts in its response that the Commission should not require the proposed change in collateral requirements to its tariff and its lending documents. Kern River argues that in the June 2012 Order the Commission incorrectly assumed that the relevant Kern River lending documents applies only to debt already issued, and that the lending documents automatically terminate when the last tranche of debt in effect on August 12, 2010 expires. Kern River states that if debt is issued after August 12, 2010, but prior to the time all obligations under the existing lending documents are fully paid off and satisfied, the requirement under the lending documents would continue. Kern River explains that until such time as the obligations under the existing lending documents are fully satisfied and all collateral is released by the collateral agent, it is important, to the extent a debt issuance is determined to be necessary, that Kern River have the flexibility to issue the debt within the construct of the existing lending documents.

21. Moreover, Kern River states, it cannot unilaterally create a new set of lending documents for new debt because all of Kern River's firm transportation agreements have already been assigned as security for the existing debt. It asserts that if Kern River sought such a change it would result in a higher interest rate, and the higher cost would unfairly be borne by creditworthy shippers.

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<sup>21</sup> *Id.* P 66 and P 73.

<sup>22</sup> June 2012 Order, 139 FERC ¶ 61,221 at P 42.

<sup>23</sup> *Id.* P 44.

## II. Discussion

### A. Rehearing

22. The Commission denies Kern River's request for rehearing and reaffirms its interpretation of Kern River's existing tariff requirement of 12-months collateral for non-creditworthy shippers, as expiring when Kern River's existing lending agreements as of August 12, 2010 expire. As the Commission has explained, under its policies collateral of longer than three months is permissible only with respect to those shippers that are signing up for new construction.<sup>24</sup> For pre-existing shippers (that are not subject to construction collateral requirements) or new shippers on the existing pipeline, the Commission's policy is to permit only three months of collateral.<sup>25</sup>

23. In the 2009 NGA section 5 proceeding, the Commission recognized that Kern River warranted a limited exception from this policy because its current lending documents were predicated on a requirement of 12-months collateral from all Kern River's shippers (those part of the construction and any new shippers). The Commission recognized the lenders' reliance interest on that collateral requirement and therefore found that the 12-month collateral would apply to all Kern River's "current lending" agreements.

24. Kern River argues that by accepting its unprotested filing to comply with the NGA section 5 order, the Commission implicitly was reversing its prior order and permitting Kern River to continue indefinitely to add additional lending documents to its Trust Indenture Agreement. But as the Commission explained in the June 2012 order, such an interpretation would be at odds with the Commission's ruling in the section 5 proceeding, limiting the 12-month collateral requirement to the existing lending agreements.

25. Kern River's position is that the phrase in GT&C definition § 29.2(1.0.0) "as amended and supplemented from time to time" covers any document executed in the future, as well as those then in existence, as long as they were related in any way to the 2001 Trust Indenture. However, as the Commission explained in the June 2012 Order,

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<sup>24</sup> The terms of collateral requirements for construction projects are to be reflected in the precedent agreements or in the individual service agreements of those shippers, but should not be included as part of the pipeline's tariff. Policy Statement, FERC Stats. & Regs. ¶ 31,191 at P 18; *North Baja Pipeline, LLC*, 102 FERC ¶ 61,239, at P 15 (2003).

<sup>25</sup> *Gas Transmission N.W. Corp. v. FERC*, 504 F.3d 1318, 1321 (D.C. Cir. 2007) (affirming three month collateral policy).

the tariff provision filed by Kern River is ambiguous, and, as such, must be interpreted in light of the underlying order to which Kern River was complying.<sup>26</sup> That underlying order was specific in limiting the scope of the 12-month collateral requirement to the expiration of the current lending agreements on which that requirement was based. The Commission recognized that Kern River's "lenders have reliance interests in their existing lending agreements and the Commission will not question the criteria in those documents at this late stage."<sup>27</sup> However, because these pre-existing lending documents were the source of the 12-month security requirement, the Commission, under section 5, required Kern River to specifically reference its "current lending documents" in its tariff.

26. Section 29 of Kern River's tariff refers to "furnish[ing] security as required by Transporter's Current Lending Documents."<sup>28</sup> This phrase is consistent with the Commission's section 5 order and limits the scope of the collateral only to current lending agreements. In defining the meaning of "Current Lending Documents" Kern River's tariff states that this phrase "means the Trust Indenture dated as of August 13, 2001, among Kern River Funding Corporation, Kern River Gas Transmission Company, as guarantor, and the trustee, as amended and supplemented from time to time." We find Kern River's interpretation of the phrase "as amended and supplemented from time to time" unreasonable as it effectively negates the ordinary meaning of "current." In fact, as the June 2012 order pointed out, Kern River itself recognizes that changes such as a reduction in collateral from a non-creditworthy shipper would require a "supplement" to the lending documents.<sup>29</sup> The most reasonable interpretation in context of that phrase is that it references such changes to the existing lending agreements, not the addition of new future lending documents. A contract should be interpreted in a way to give reasonable

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<sup>26</sup> The Commission's acceptance through a delegated letter order of an unprotested filing should not be viewed as eviscerating the Commission's prior section 5 determination, particularly when the tariff filing is ambiguous and can be interpreted as consistent with the Commission's section 5 requirement.

<sup>27</sup> *Kern River Gas Transmission Co.*, 139 FERC ¶ 61,221 at P 41.

<sup>28</sup> Sheet No. 297, GT&C Establishment and Maintenance of Credit, 1.0.0, (§29.2) (<http://etariff.ferc.gov/TariffSectionDetails.aspx?tid=1348&sid=113612>).

<sup>29</sup> Kern River Compliance Filing, Docket No. RP12-250-000, at 6 (February 14, 2012) ("Kern River's lending documents do not provide for exceptions to be made to the credit support requirements imposed thereby. Therefore, any exception approved by the lenders would constitute a 'supplement' to the lending documents. The process for supplementing the trust indenture is set forth in Article VII of the trust indenture.").

meaning to all its terms.<sup>30</sup> Kern River's interpretation of the phrase "as amended and supplemented from time to time" as applying to future agreements would render the term "current" in the tariff language "of no effect" and is therefore rejected. As the June 2012 order explained "While Kern River's tariff specifically bases the collateral requirements on the trust indenture 'as amended and supplemented from time to time,' we interpret that clause as referring to changes to the Trust Indenture related to Kern River's debt as it existed August 12, 2010, not to the addition of future lending documents or the modification of existing lending documents to incorporate new or refinanced debt."<sup>31</sup>

27. Accordingly, the Commission denies rehearing.

**B. Section 5 Proceeding**

28. In the June 2012 order, the Commission acted pursuant to NGA section 5 to require Kern River to clarify its tariff language to be clear that any collateral requirement in its tariff longer than three months should be limited to the expiration of Kern River's debt as it existed on August 12, 2010. Kern River advances a number of arguments why it should not be required to revise its tariff. But, for the reasons discussed above, we do not find that Kern River warrants an exception from the usual three-months collateral requirement as applied to existing shippers or to new shippers on its existing system. Kern River's prospective lenders also have been on notice since August 12, 2010, that upon the expiration of the existing lending agreements their collateral requirement from existing shippers would be limited to three months collateral.

29. Kern River argues that it cannot enter into a new set of lending agreements because all of its firm transportation agreements have been assigned as security for the existing debt. It argues that any new arrangement would result in a higher interest rate. In the first place, Kern River misperceives the effect of the Commission's section 5 order. Under the Commission's order, Kern River can maintain its current security requirement until the latest date when all of its existing lending agreements expire. This requirement could apply to any new lending agreements into which Kern Rivers enters into until that date. After that date, security for all existing shippers will be set equal to three-months' reservation charges. With respect to obtaining financing for new projects, Kern River,

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<sup>30</sup> Restatement (Second) of Contracts § 203 (1981) ("an interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect").

<sup>31</sup> June 2012 Order, 139 FERC ¶ 61,221 P 44.

like all pipelines, will be able to include reasonable security agreements in precedent and service agreements with the shippers on those projects.

30. We therefore find no reason to treat Kern River any differently than other natural gas pipelines are treated with respect to the collateral requirement for non-creditworthy shippers to continue to receive service. Pursuant to NGA section 5, we require Kern River to file a revision to Section 29.2 of the GT&C, to be effective the date of this order, specifying that a non-creditworthy shipper may continue to receive long term firm service if it furnishes the following security. Until the end of the current terms of any of Transporter's Lending Agreements as they existed on August 12, 2010, Transporter may require security as required by those agreements and its 2001 Trust Indenture. Upon the expiration of the latest term of a current Lending Agreement that existed on August 12, 2010 (not including any rollover or other extension of that or any other agreement), Transporter may require security equal to no more than three months of reservation charges.

The Commission orders:

(A) Kern River's request for rehearing is denied.

(B) Within 15 days of this order, Kern River must file revised tariff records as discussed in the body of this order and the June 2012 Order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.