146 FERC ¶ 61,026
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Portland Natural Gas Transmission System Docket No. RP13-874-001

ORDER REJECTING INITIAL AND COMPLIANCE FILINGS

(Issued January 16, 2014)

1. On June 17, 2013, Portland Natural Gas Transmission System (Portland) filed revised tariff records to comply with the Commission's order issued on May 31, 2013.[1] The May 31, 2013 Order accepted certain tariff records filed by Portland to update and restructure the creditworthiness determination and financial assurances provisions in its General Terms and Conditions (GT&C) subject to conditions to be effective June 1, 2013. Portland requests that the Commission also accept the proposed tariff records to be effective June 1, 2013. As discussed below, after reviewing the compliance filing, the Commission rejects the initial and compliance filings in this docket.

<u>Background</u>

2. On May 1, 2013, Portland filed revised tariff records to restructure the creditworthiness determination and financial assurances provisions contained in Sections 6.3.4 through 6.3.7 of its GT&C. Among the modifications, Portland proposed to include a determination of the present value (PV)[2] of the shipper's payments over the term of its

[1] *Portland Natural Gas Transmission System*, 143 FERC ¶ 61,189 (2013) (May 31, 2013 Order).

[2] Portland uses the term present value in its currently effective tariff, and its formula is a present value formula. In some instances the term net present value (NPV) is used in this proceeding. Present value is the result of discounting future amounts to the present. Net present value is the present value of the cash inflows minus the present value of the cash outflows. Neither Portland's existing present value (PV) nor its proposed formula take into account cash outflows. If there are no cash outflows, the PV and NPV formulas yield identical results.

contract in two elements of its creditworthiness evaluation methodology. First, it proposed to revise its generally applicable creditworthiness standard by lowering the minimum required Standard and Poor's (S&P) debt rating from BBB to BBB- and the Moody's debt rating from Baa2 to Baa3, while at the same time adding a tangible net worth requirement. The latter requirement would limit the present value of the shipper's overall payments under the contract to no more than 10 percent of its tangible net worth, as follows:

> the contractual obligation derived from the sum of reservation charges for the contract term, on a net present value basis, plus applicable commodity charges and any other associated fees and charges, plus the value of any loaned or imbalance gas, is no greater than 10% of Shipper's Tangible Net Worth.[3]

3. Second, Portland proposed to modify its tariff with regard to the financial guarantee from the shipper's parent or a third party which the shipper can provide in order to receive firm service if it fails to satisfy the above creditworthiness standard. While the previous tariff required the guarantee to cover only three months of firm reservation and usage charges, the revised tariff provides that the guarantee must cover the shipper's entire "contractual obligation derived from the sum of reservation charges, on a net present value basis."[4] Portland recognized that the Commission's general policy is to permit pipelines to require shippers that fail to meet the pipeline's creditworthiness requirements for pipeline service to provide collateral equal to three months of reservation charges. However, Portland argued that the Commission considers that a guarantee by a parent or third party of the contractual obligation of a shipper is an alternative to the provision of collateral and that the pipeline can require that the guarantee cover the full extent of the shipper's obligation.[5] Therefore, Portland proposed to increase its guarantee amount for firm service to be equal to the contractual obligation for the entire term of the contract derived from the sum of reservation charges on a present value basis.

4. DTE Energy Trading, Inc. (DTE) protested Portland's guarantee proposal arguing that Portland should be required to include objective standards in its tariff for calculating the present value of the guarantee amount a shipper would be required to provide. On

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[3] Part 6.3 GT&C, Requests for Service/Creditworthiness, 1.0.0 (§6.3.4.1 (2)(a)).

[4] Part 6.3 GT&C, Requests for Service/Creditworthiness, 1.0.0 (§6.3.4.2(3)).

[5] Portland May 1, 2013, Transmittal Letter at p. 8 (citing *PG&E Gas Transmission, Northwest Corp.*, 105 FERC ¶ 61,382, at P 80 (2003)).

May 16, 2013 Portland answered DTE's protest[6] and asserted that the Creditworthiness Policy Statement did not specify the present value methodology for the calculation of contractual obligations for purposes of providing a guarantee.[7] Portland then cited a delegated letter order to support its contention that other pipelines had proposed similar tariff language which was accepted by the Commission without a requirement to include such an objective standard in the tariff.[8]

5. The Commission found that Portland's proposals were generally consistent with Commission precedent to the extent that they were adequately explained by Portland.[9] In particular, the Commission agreed with Portland that under its creditworthiness policy, a guarantee may cover more than three months of reservation charges.[10] However, in regard to Portland's proposal to increase its guarantee amount to be equal to the contractual obligation derived from the sum of reservation charges on a present value basis and whether Portland's tariff must contain a formula to reflect its calculation of the present value of the guarantee, the Commission required a compliance filing.[11]

6. The Commission noted that Portland's tariff at GT&C Section 6.2 Definitions, contained a provision stating that "Except where another meaning is expressly stated, the following terms shall have the following meanings when used in this tariff and in any Gas Transportation Contract incorporating this Tariff." This is followed by Section 6.2.33 entitled Present Value. Section 6.2.33 provides a complete formula for deriving

[6] Although Rule 213(a)(2) of the Commission's Rules of Practice and Procedure [18 C.F.R. § 385.213(a)(2) (2012)] prohibits answers to protests or answers unless otherwise permitted by the decisional authority, the Commission accepted Portland's answer because it provided information that assisted the decision-making process. *Portland Natural Gas Transmission System*, 143 FERC ¶ 61,189 at P 5.

[7] Portland Answer at 4 (citing *Policy Statement on Creditworthiness Issues for Interstate Natural Gas Pipelines and Order Withdrawing Rulemaking Proceeding*, 111 FERC ¶ 61,412 (2005)).

[8] *Id.* (citing Gas Transmission Northwest LLC ("GTN") FERC Gas Tariff Section 6.18.4.2, para. (3), accepted by the Commission on September 21, 2012, in Docket No. RP12-980-000).

[9] May 31, 2013 Order, 143 FERC ¶ 61,189 at P 6.

[10] *Id.* P 10.

[11] *Id.* P 15.

present value including a term stating the interest rate to be used in such calculation must be the monthly equivalent of the prime rate, as published in the Wall Street Journal, plus five percent (5%).[12]

7. Therefore, because Portland's tariff specifically defined how present value was to be calculated under any Portland tariff provision or transportation contract, the Commission accepted Portland's proposed provision on condition that Portland inform the Commission whether Portland intended that the current tariff definition of present value would apply to its proposed determination of creditworthiness methodology or to explain why its current tariff definition of present value is inapplicable to its proposal, and to propose a revised definition and/or applicable tariff modification.[13]

Details of the Instant Filing

8. Portland states that to comply with the May 31, 2013 Order, it submits tariff records reflecting modifications to tariff Section 6.3.4 in order to set forth a present value formula to be used within the creditworthiness provisions. Portland states that it proposes a formula to derive the sum of the present values of the monthly reservation charge billings for the number of months remaining on the firm transportation agreement. In addition, Portland asserts that its proposed formula provides for a discount factor (i.e., interest rate) based on the monthly equivalent of the "52 Weeks" (Coupon Equivalent) treasury bill rate, as reported by the U.S. Department of Treasury, as of the first reportable day for each month. Portland also states that its current section 6.2.33 (containing its current formula for deriving present value using the prime rate, as published in the Wall Street Journal, plus five percent (5%)) has been modified to specifically exclude the proposed tariff Section 6.3.4.

9. Portland explains that its Present Value formula as set forth in its current tariff section 6.2.33, is specifically intended for use in deriving comparative economic valuations as between competing bids for capacity or multiple service agreements. For example, Portland states that this formula would be used to determine the best bid in a capacity release arrangement or to determine the order of transportation service curtailment.[14] Portland asserts that for these types of comparative purposes, the interest rate stated in Section 6.2.33 is not significant.

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[12] *Id.* P 14.

[13] *Id.* P 15.

[14] Portland also uses present value to determine the value of bids submitted for capacity in open seasons. Section 6.13 of Portland's GT&C states in part:

(continued…)

10. Portland asserts that for purposes of establishing guarantor obligations, the interest rate used serves a different purpose and is significant in determining the present value of the contractual obligation of the subject contract(s) being guaranteed. Portland continues stating that for purposes of determining guarantee amounts, a more appropriate present value formula is one that includes a discount factor that is more in line with current economic conditions, yet still enables the recovery of reservation charge obligations (i.e., via a lower discount rate).

11. Portland asserts that its proposed use of the treasury bill rate in its PV analysis is more logical than the rate provided in tariff Section 6.2.33, because the treasury bill rate reflects current economic conditions at any point in time. Portland argues that the use of the treasury bill rate is also a more appropriate way to align guarantee values more closely to the contractual obligation of reservation charges, thus providing protection to both Portland and its non-defaulting shippers. Lastly, Portland asserts that the Commission has not required a guarantee to be valued on a present value basis.[15]

Public Notice and Comment

12. Public notice of the instant filing was issued on June 19, 2013 with comments due on July 1, 2013. Comments were filed by DTE Energy Trading, Inc. (DTE). DTE

> (e) Valuation of Bids. Unless otherwise specified in its open season posting, when evaluating bids for firm capacity, the bid(s) with the greatest economic value will be the bid(s) with the highest Present Value in accordance with Section 6.2.33 of these General Terms and Conditions. If the economic values of separate bids are equal, then service shall be offered to such requestors on a pro-rata basis.

Part 6.13 GT&C, Requests for Service/Creditworthiness, 1.0.0, http://etariff.ferc.gov/TariffSectionDetails.aspx?tid=2233&sid=138934.

[15] Portland June 17, 2013 Transmittal Letter at 4 (citing *PG&E Gas Transmission, Northwest Corp.*, 105 FERC ¶ 61,382, at P 80 (2003) ("A guarantee by a parent or third party of the contractual obligation of a shipper is an alternative to the provision of collateral... the guarantee is in lieu of providing the collateral. Thus, GTN is correct that it can require that the guarantee cover the full extent of the shipper's obligation."); *Texas Gas Trans., LLC*, 135 FERC ¶ 61,132, at P 35 (2011) ("As the Commission has explained, in the case of a guarantee, the parent or third party is guaranteeing that in the event of a default by the shipper, the guarantor will pay the applicable charges, not just the collateral.")).

asserts that it is not appropriate for Portland to require a long-term firm shipper seeking to establish creditworthiness using a third party or parental guarantee to provide a guarantee amount calculated using a NPV based upon the 52-week Coupon Equivalent Treasury Bill rate. DTE asserts that the use of such a short-term interest rate in the NPV calculation for a long-term contract leads to the overstatement of the guarantee amount that a long-term shipper would be required to provide in order to establish creditworthiness where applicable.

13. DTE states that it holds a maximum rate firm transportation contract with Portland that has an MDQ of 30,000 Dth per day at $40.2456 per Dth which will expire on March 9, 2019. DTE states that, under Portland's proposed NPV formula, DTE would be required to provide a corporate guarantee of $82,969,153 as of June 1, 2013. DTE states that the sum of the undiscounted reservation charges that it has contracted to pay for the remainder of its contract term totals $83,308,392.11. Therefore, DTE concludes that the use of the Treasury Bill rate places an undue burden on long-term firm shippers that need to use a third party guarantor.

14. DTE suggests that the Commission direct Portland to calculate the amount of a long-term firm shipper's guarantee by including in the NPV formula an interest rate that reflects the term of the contract and the fact that Portland has the opportunity to earn a return that greatly exceeds the one-year Treasury Bill rate. Therefore, DTE asserts that Portland should be required to calculate a firm shipper's guarantee amount using Portland's weighted cost of capital. DTE states that Portland weighted cost of capital as reflected in its last rate case is 9.3 percent.[16] DTE states if this factor is used instead of the treasury bill rate in Portland's proposed NPV calculation DTE's guarantee amount falls to $64, 269,246. DTE asserts that requiring Portland to use its weighted cost of capital instead of the treasury bill rate is just and reasonable.

15. On July 10, 2013, Portland filed an answer to DTE's comment.[17] Portland asserts that DTE objects to the discount rate contained within Portland's proposed present value formula and recommends a higher discount rate which would lower a guarantor's payment obligations. Portland states that the Commission stated in its May 31, 2013

[16] DTE Comments at 7 (citing Portland Natural Gas Transmission System Compliance filing in Docket No. RP10-729-000 dated April 22, 2013, Appendix 3, Revised Statement F-2, Primary Case, Page 10 of 19, Line 3).

[17] Rule 213(a)(2) of the Commission's Rules of Practice and Procedure prohibits answers to protests or answers unless otherwise permitted by the decisional authority. [18 C.F.R. § 213(a)(2) (2012)] In this case the Commission will accept Portland's answer because it provides information that will assist us in our decision-making process.

Order that a guarantee may cover the full extent of the shipper's contractual obligation. Accordingly, Portland asserts that the Commission did not open for debate the method of calculating the present value of contractual obligations. Portland argues that it is not required to offer any discount method for calculating the shipper's contractual obligation as shown by the Commission's policy which states that a guarantee may cover the full extent of the shipper's contractual obligation. Therefore, Portland asserts that the discount factor contained within its proposed formula is not subject to DTE's scrutiny.

Discussion

16. In its May 1, 2013 filing, Portland proposed to modify several of the creditworthiness provisions of its tariff to include a calculation of present value for credit purposes. The Commission accepted this proposal subject to a condition. As noted in the May 31, 2013 Order, one party, DTE, objected to Portland's proposal and argued that Portland should be required to include objective standards in its tariff for calculating the present value of the guarantee amount a shipper would be required to provide. Portland answered DTE's protest and asserted that there was no requirement for any particular present value methodology for the calculation of contractual obligations for purposes of providing a guarantee and that the Commission did not require other pipelines to provide such an objective standard in the tariff. In its May 31, 2013 Order, the Commission stated that it reviewed Portland's Answer, and noted that Portland's tariff already specifically defined how present value was to be calculated under any Portland tariff provision or transportation contract.[18] Therefore, the Commission found that an explanation was necessary before it was certain that it fully understood the ramifications of Portland's proposal.[19] Specifically, the Commission required that it would accept the filing on the condition that:

> Portland make a compliance filing, within 15 days of this order, either informing the Commission whether Portland intends that the current tariff definition of present value applies to its proposed determination of creditworthiness

[18] May 31, 2013 Order, 143 FERC ¶ 61,189 at P 15.

[19] As Portland describes the Commission's conundrum, "[T]hus, the Commission finds that [Portland's] Tariff does specifically define how present value is to be determined, yet in its Answer to DTE's Comments, [Portland] states that it need not provide a specific present value methodology for contractual obligations." Portland June 17, 2013 Transmittal Letter at 3.

> methodology or explaining why the tariff definition of present value is inapplicable to its instant proposal, and proposing a revised definition and/or applicable tariff modification. *Id.*

17. In the instant filing, Portland informs the Commission that it finds unacceptable the use of its existing present value formula based on the prime rate plus 5 percent for creditworthiness purposes and proposes a new present value formula to be used within the creditworthiness provisions of its tariff. Portland explains that its current Present Value formula is intended for use in comparing the value of multiple contracts and that for this purpose "the interest rate stated in GT&C Section 6.2.33 is not significant."[20] However, Portland maintains, for establishing guarantor obligations, interest rate is significant in determining the present value of the contractual obligation of the subject contract(s) being guaranteed. Therefore, Portland argues that for purposes of determining guarantee amounts, its new PV formula, which includes a discount factor that is in line with current economic conditions, is preferable to its current PV formula. In essence, the only difference between the PV formula in Portland's tariff and the new additional PV formula it proposes is that the interest rate of the latter is based upon based on the monthly equivalent of 52-week treasury bill rate whereas the current PV is based upon the monthly equivalent of the prime rate, as published in the Wall Street Journal, plus five percent.

18. In its compliance filing, Portland indicates that it does not accept the Commission's interpretation of its initial filing as applying the present value calculation already contained in Portland's tariff. As discussed below, we cannot find just and reasonable Portland's proposal to establish different present value calculations for the determination of credit than for other purposes. Since the present value calculation is an integral part of Portland's filing, and Portland's filing is predicated on the Commission accepting a difference in present value calculations for credit purposes, and the Commission does not find this proposal just and reasonable, the Commission will reject the filing in Docket No. RP13-874-000.

A. Use of a Different Present Value Formula for the Tangible Net Worth Calculation

19. We find unjust and unreasonable Portland's proposal to establish a different present value formula for the tangible net worth calculation component of its creditworthiness determination (and for the guarantee) than for other determinations. The purpose of using a present value formula, with a specific discount rate, is to determine the amount that a future stream of reservation payments is worth to the pipeline today. The

[20] June 17, 2013 Filing at 3.

value to the pipeline of a shipper's contract does not change regardless of the purpose for which the calculation is made.

20. The only difference between the two present value formulas presented by Portland is the discount rate. In the existing formula in its tariff (used for comparing the present value of multiple contracts) Portland uses an interest rate based upon the monthly equivalent of the prime rate, as published in the Wall Street Journal, plus five percent. In its proposed discount rate for credit purposes, Portland uses a much lower discount rate based upon the monthly equivalent of the 52-week treasury bill rate. In choosing a discount rate, a pipeline should choose a rate that most accurately reflects the opportunity cost of the contract relative to other potential investments, in other words, what it could earn if it had the money today rather than in the future. As indicated by the request of the protester in the instant proceeding, a common discount rate used by firms is their weighted average cost of capital.

21. Portland maintains that it is reasonable to use two different discount rates depending on the purpose for which the present value formula is used: comparing contracts as opposed to determining the value of a contract for credit purposes. It maintains that the discount rate used for comparative purposes is "not significant."

22. However, Portland has not provided support for finding that the 52-week treasury bill rate reflects its reasonable opportunity cost. For example, under Portland's current present value methodology (Wall Street Journal's (WSJ) Prime rate plus 5 percent, currently an annual rate of approximately 8.5 percent), a contract with a twenty year term and equal annual monthly reservation charge payments for transportation service of $1000/month, would be valued at approximately $115,231,000. The same contract under Portland's proposed creditworthiness present value formula (the 52-week Coupon Equivalent Treasury Bill rate, currently an annual rate of approximately 0.09 percent) the value of the transportation service would be approximately $237,844,000. Portland has not provided sufficient support for concluding that its reasonable opportunity cost of money is twice as high as its current PV formula would indicate.

23. Nor has Portland justified its assertion that the present value calculation for contract comparisons is "not significant." The purpose of using present value to compare contracts is to permit the pipeline to select the contract which it values the most. Portland therefore should use the discount rate that most accurately reflects its actual opportunity costs. Choosing a rate for comparative purposes that does not reflect Portland's reasonable opportunity costs is unfair to shippers competing for capacity. For example, under the current present value formula in its tariff, Portland generally favors contracts that provide it with the most revenue at the earliest time as compared with contracts that

may provide more total revenue, but spread that revenue out over time.[21] However, if the lower discount rate proposed for credit purposes reflects Portland's opportunity costs, the longer term contract should be considered much more valuable and that shipper might well have prevailed. All shippers should be entitled to an objective determination of the value of their proposed contracts based on a reasonably accurate determination of the value of those contracts to the pipeline. For this reason, we find Portland's use of two different present value calculations unjust and unreasonable.

B. <u>Use of a Present Value Calculation in Determining the Value of a Guarantee</u>

24. In its tariff, Portland seeks to establish a value to be applied to a guarantee of a contract. Portland asserts that its use of its proposed present value formula calculation for this purpose accords with Commission policy that a guarantee covers the full extent of a shipper's obligation and does not require that a guarantee be valued on a present value basis.

25. Portland, however, misperceives Commission policy relative to guarantees, and, upon further consideration, we find Portland's proposal to calculate the present value of a guarantee unjust and unreasonable. As pointed out by Portland, the Commission has recognized that a guarantee can cover the full extent of the shipper's obligation to the pipeline.[22] Under Commission policy, the guarantor is liable for each reservation charge payment as it becomes due. In providing a guarantee, a guarantor provides no funds to the pipeline, it merely undertakes the obligation to continue the same stream of payments owed by the original shipper. Because other factors, such as mitigation, affect the current value of a guarantee, and the value of a guarantee is determined through litigation, a tariff provision determining the present value of the guarantee is confusing and unnecessary.

26. Portland's proposal goes beyond merely requiring a guarantee of payments as they become due. It seeks to monetize the value of the guaranteed contract in lieu of the guarantor's making the required monthly payments in the event of a shipper default.

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[21] The use of a higher discount rate results in a lower present value calculation, *ceteris paribus*, than the use of lower discount rate. *See* Section 6.13 of Portland's GT&C (providing that unless otherwise specified in its open season posting, when evaluating bids for firm capacity, the bid(s) with the greatest economic value will be the bid(s) with the highest Present Value in accordance with Section 6.2.33 -- which contains the current PV formula containing an interest rate derived from the WSJ prime rate plus 5 percent).

[22] May 31, 2013 Order, 143 FERC ¶ 61,189 at P 10. *See supra* n.15.

Such a monetary value would be relevant only for the purpose of determining the damages suffered by the pipeline as a result of the shipper's breach of its contract, if the pipeline sued the shipper for damages in court. The Commission, however, has found that it is not appropriate in a tariff for the pipeline to seek to establish values applicable to contractual breaches, which is better left for the parties or appropriate courts to resolve.[23]

27. The Commission's policy of leaving contract valuation to the parties and appropriate judicial proceedings is based, in part, on the fact that, under standard contract damage calculations, pipelines would be required to mitigate damages. As the Commission has stated, "pipelines should be required to mitigate the consequences of a shipper's default. In the event of default and termination, the pipeline will be required to reduce the collateral it retains by mitigating damages."[24] Because consideration of all the valuation factors inherent in contract valuation must be determined in appropriate judicial proceedings, we do not find reasonable Portland's proposed present value calculation for guarantees or the proposal to include such a partial valuation of a guarantee in its tariff.

C. <u>Rejection of Portland's Filing in Docket No. RP13-874-000</u>

28. Because Portland is proposing to use two different PV formulas, which as explained above, the Commission finds unjust and unreasonable, and the present value formula is integral to the filing, the Commission is rejecting Portland's filing in this docket. Portland's proposed formula for calculating the present value of contractual obligations is incorporated into its overall proposal to restructure the creditworthiness provisions of its tariff. As described previously, Portland proposed to revise its generally applicable creditworthiness standard by lowering the minimum required debt rating by one notch, from BBB to BBB- (Standard and Poor's) and Baa2 to Baa3 (Moody's) while

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[23] *See Tennessee Gas Pipeline Company*, 103 FERC ¶ 61,275, at P 84 (2003) (explaining that Tennessee's may bring an action for consequential, and unmitigated damages occasioned by a shipper's contractual breach and "that is a contractual action that must be brought in the appropriate jurisdiction"); *Enbridge Offshore Pipeline L.L.C.*, 116 FERC ¶61,194 at P 12 (2006) (distinctions such as the differences between direct and indirect damages "is for the courts to resolve") (citing *Entrega Gas Pipeline Inc.*, 112 FERC ¶ 61,177, at P 66 (2005)). *See also Midwest Indep. Transmission Sys. Operator, Inc.*, 110 FERC ¶ 61,164, at P 35 (2005) (finding that a proposed definition of direct damages was ambiguous and that the question of what constituted direct damages was "one for the courts, who are familiar with the concepts of direct and consequential damages.").

[24] *Northern Natural Gas Co.*, 103 FERC ¶ 61,276, at P 18 (2003) (*Northern Natural*).

at the same time adding a requirement that would limit the present value of the shipper's overall payments under the contract to no more than 10 percent of its tangible net worth. We do not know to what extent the proposal to lower the minimum required debt rating may have been predicated on the proposed tangible net worth calculation. Since it appears that Portland's proposal to restructure its creditworthiness provisions may have been predicated on the Commission accepting the proposed present value calculations, which we have found to be unjust and unreasonable, the Commission finds that Portland has not satisfied its burden to show that its filing is just and reasonable and therefore we reject the filing.[25] Our rejection of the filing is without prejudice to Portland making a new section 4 filing to restructure its creditworthiness provisions consistent with the above discussion.

The Commission orders:

Portland's tariff filing in Docket No. RP13-874-000 is rejected.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[25] *See Columbia Gulf Transmission Company*, 134 FERC ¶ 61,194 (2011) (rejecting filing when pipeline did not agree with Commission's interpretation of its tariff and the Commission found the pipeline's interpretation of its tariff unjust and unreasonable).