ELECTRIC LIGHT & POWER

Benefit of counsel

On borrowed dime: The credit crunch hits the gas pipeline industry

STEFAN M. KRANTZ AND DEBRA H. REDNIK, DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP

The credit crunch currently facing the energy industry shows no signs of abating. Rating downgrades and bankruptcy proceedings dominate energy news. Standard & Poor's reports that it downgraded 182 investor-owned utilities in 2002—a trend that appears to be continuing. Consequently, these entities are canceling or postponing gas-fired generation projects, the engine of electricity infrastructure and the largest growth sector in natural gas demand. And, as natural gas prices continue to skyrocket, development of pipeline infrastructure to carry tomorrow's supplies must be the Federal Energy Regulatory Commission's (FERC) paramount objective. The credit crunch is proving yet again that convergence of the gas and electricity markets is not simply a theory.

Debra H. Rednik, Dickstein Shapiro Morin & Oshinsky LLP

Stefan M. Krantz, Dickstein Shapiro Morin & Oshinsky LLP

As the dominos continue to fall, natural gas pipelines are tabling new construction projects and becoming increasingly nervous about their ability to collect payment from their customers, many of whom are in serious financial trouble. Pipelines have responded by seeking tighter creditworthiness standards to ensure that customers that become non-creditworthy (by virtue of a rating downgrade, insolvency or bankruptcy) do not leave the pipeline with inadequate collateral or, ultimately, with unmarketable capacity no longer under contract. Pipelines believe that this is the only way to create sufficient certainty to warrant investment in new pipeline infrastructure.

In the last two months, FERC has attempted to address these critical credit issues. In *Tennessee Gas Pipeline Company*, 102 FERC ¶° 61,075 (2003) and *Northern Natural Gas Company*, 102 FERC ¶° 61,076 (2003), FERC reviewed proposals to strengthen pipeline creditworthiness provisions. In both cases, FERC essentially sided with the pipelines' shippers, finding that shippers should be afforded more than five business days within which to post collateral; that collateral should be limited to three months of charges, although a pipeline may require twelve months collateral for new construction; that a pipeline may not confiscate gas left on the system by a non-creditworthy shipper that defaults on its contract; and that a pipeline may not assess transportation charges when it suspends service for failure to maintain creditworthiness.

In addition, FERC, on its own initiative, applied these holdings to a third pipeline. *North Baja Pipeline LLC*, 102 FERC ¶° 61,239 (2003). While crafting new policy on a case-by-case basis rather than through an industry-wide proceeding in which all affected parties could participate, FERC has also directed the North American Energy Standards Board to fashion creditworthiness standards consistent with the policy FERC develops through these various proceedings.

Although FERC's emerging policy attempts to strike a balance between the pipeline industry's security needs and the financial stress currently facing shippers, the pipeline community fears that this policy may actually threaten the development of pipeline infrastructure necessary to meet emerging demand for natural gas. As natural gas prices reach unprecedented levels, all market participants agree that the construction of new pipeline infrastructure to carry tomorrow's gas supplies will be an essential element in meeting the country's emerging energy needs. Yet, the pipelines that will bear the risk of such construction assert that FERC's failure to protect their investment in infrastructure may prevent them from meeting the industry's growth requirements.

Critics of FERC's recent actions argue that its emerging policy simply fails to accommodate the very different credit situations and corporate structures of pipeline families, which will result in a one-size fits all approach that fits no one. These critics claim that FERC's piece-meal decision-making will result in a policy that inhibits the development of pipeline infrastructure (antithetical to FERC's recent pronouncements designed to encourage infrastructure development), which in turn will impede the construction of gas-fired electricity generation. The credit crunch, critics argue, calls for a well-reasoned and balanced approach that accommodates pipelines' need to protect themselves against the risk of shipper default with shippers' need to continue receiving transportation service. Supporters of FERC's policy argue that now is the wrong time to increase credit obligations, as credit is increasingly difficult to obtain. They also contend that FERC's uniform standards provide pipelines with adequate security. Critics counter that pipeline credit requirements must increase to offset non-payment risk, which grows as shippers' credit quality declines.

FERC must resolve this debate to address the credit crunch and avoid the creation of new obstacles to meeting the nation's immediate and growing energy needs. ELP

Since this article was published in Electric Light & Power April 2003, Krantz and Rednik are now with Hogan & Hartson, L.L.P. www.hhlaw.com.

HOGAN & HARTSON LLP