

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

APPLICATION OF

VIRGINIA NATURAL GAS, INC.

and

SEQUENT ENERGY MANAGEMENT, L.P.

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CASE NO. PUR-2018-00203

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For approval of an Asset Management
Agreement under Chapter 4, Title 56
of the Code of Virginia

REPORT OF MICHAEL D. THOMAS, SENIOR HEARING EXAMINER

February 28, 2019

HISTORY OF THE CASE

On December 28, 2018, Virginia Natural Gas, Inc. ("VNG" or "Company"), and Sequent Energy Management, L.P. ("Sequent") (collectively, "Applicants"), filed an application with the State Corporation Commission ("Commission"), pursuant to Chapter 4, Title 56 of the Code of Virginia ("Code"),¹ seeking approval of an Asset Management and Agency Agreement ("AMAA") under which Sequent would provide natural gas supply and asset management services to VNG ("Joint Application").²

The currently approved AMAA and Gas Purchase and Sale Agreement ("GPSA") (together, "2018 Agreements") between VNG and Sequent end on March 31, 2019. The Applicants requested approval of the Joint Application on or before March 15, 2019, to allow sufficient time for Sequent and VNG to execute the proposed AMAA and perform various administrative tasks for Sequent to begin procuring baseload and storage gas for VNG on or before March 25, 2019.³

The Application provided a completed transaction summary supporting the Joint Application as Attachment A ("Transaction Summary"). In addition, the proposed AMAA was included as Attachment B (Confidential). The proposed AMAA includes the Terms of Gas Purchase and Sale ("GPS") as Exhibit C, thereto.⁴

Pursuant to the proposed AMAA, Sequent would provide natural gas supply and asset management services with respect to VNG's portfolio of gas supply, transportation, and storage assets (as specifically set forth in Exhibit A to the AMAA, "VNG Assets"). The proposed AMAA describes the services that are provided to VNG by Sequent, the method for determining gas costs,

¹ Section 56-76 *et seq.* of the Code ("Affiliates Act").

² Joint Application at 1.

³ *Id.* at 1-2.

⁴ *Id.* at 2.

the structure for compensating Sequent for the services provided to VNG, and the methodology for calculating and sharing margins generated with the proposed AMAA.⁵

The proposed AMAA establishes the annual guaranteed minimum payment to be paid by Sequent to VNG, regardless of the value created by Sequent's management of VNG's assets. The proposed AMAA also establishes the sharing arrangement after the annual guaranteed minimum payment has been met. VNG's portion of the value created by the proposed AMAA is returned to customers through the Purchased Gas Adjustment and Actual Cost Adjustment mechanism set forth in Section XX of VNG's tariff.⁶

The proposed AMAA provides for a primary term of two years from the effective date. The proposed AMAA further provides for the ability to extend the term of the agreement for up to an additional two years so long as such extension is mutually agreed upon by the parties and approved by the Commission. The Applicants seek Commission approval of the primary term of two years, and approval to extend the proposed AMAA for up to an additional two years.⁷

If the proposed AMAA is approved, Sequent would act as agent for VNG in procuring gas for VNG's system supply based on VNG's logical dispatch plan and would continue to seek ways to create value from idle VNG Assets and share that value with VNG's customers. By continuing in the proposed AMAA to utilize the "virtual" dispatch plan currently in place under the 2018 Agreements, VNG would continue to approximate the dispatch as if it were acquiring gas on a stand-alone basis, which Commission Staff ("Staff") indicated previously is an appropriate benchmark against which the value of Sequent's performance could be determined. VNG has utilized the logical dispatch plan with the objective of providing the lowest gas cost to its customers, consistent with supply reliability and safe operations of the VNG system.⁸

The Applicants believe the proposed AMAA is in the public interest for several reasons including: (i) it is the result of a thorough and transparent competitive bidding process as directed in the Commission's June 29, 2018 Order ("June 2018 Order");⁹ (ii) it would provide significant value to customers through the annual guaranteed minimum payment and the sharing mechanism; (iii) it would provide economies of scale and other business efficiencies which would accrue to the benefit of VNG and its customers; and (iv) it would provide an arrangement where Virginia gas customers are provided pricing based on nationally recognized standards.¹⁰

On January 7, 2019, the Commission entered an Order in which it: (i) docketed the Joint Application; (ii) extended the period to review the Joint Application by 30 days;¹¹ and (iii) assigned the case to a Hearing Examiner to conduct all further proceedings in this matter on behalf of the Commission and file a final report.

⁵ *Id.* at 10.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 10-11.

⁹ *Application of Virginia Natural Gas, Inc. and Sequent Energy Management, L.P., For approval of an Asset Management Agreement under Chapter 4, Title 56 of the Code of Virginia*, Case No. PUR-2017-00122, Order (June 29, 2018).

¹⁰ Joint Application at 11.

¹¹ Pursuant to the Affiliates Act, the Commission must enter a Final Order on or before March 28, 2019.

On January 16, 2019, Enspire Energy, LLC (“Enspire”), filed a Notice of Participation and Request for Hearing (“Enspire Notice of Participation”). In support, Enspire stated that it has “a concrete interest in the outcome of this proceeding.”¹² Enspire argued that VNG’s arrangement with Sequent benefits the two affiliates, but comes at the expense of VNG’s customers and other participants in the natural gas market, including Enspire.¹³ Enspire stated that Sequent unreasonably withholds excess natural gas capacity, except when the buyer is willing to purchase a bundled product that includes both capacity and the commodity.¹⁴ Enspire contrasted Sequent’s market behavior with that of Columbia Gas of Virginia (“CGV”) which releases its available capacity by posting it to the pipeline’s electronic bulletin board (“EBB”) system and then awarding it to the highest bidder.¹⁵ Enspire stated that it has been “disadvantaged” by Sequent’s market behavior.¹⁶ Enspire requested a hearing on the merits and requested that the Commission disapprove the proposed AMAA.

A prehearing conference was held on January 17, 2019. Interested parties were advised that this matter would have an abbreviated procedural schedule because of the statutory deadline in Affiliates Act cases.¹⁷

On January 22, 2019, the Virginia Industrial Gas Users’ Association (“VIGUA”) filed a Notice of Participation and Request for Hearing (“VIGUA Notice of Participation”). VIGUA is an association that includes industrial customers of VNG.¹⁸ VIGUA stated that its members “have a concrete interest in the outcome of this proceeding.”¹⁹ VIGUA stated that VNG’s arrangement with Sequent benefits the two affiliates, but comes at the expense of VNG’s customers and other participants in the natural gas market.²⁰ VIGUA stated that VNG and Sequent have not shown that approving the proposed AMAA for two years is in the public interest.²¹ VIGUA noted that when the Commission first approved the VNG/Sequent arrangement in 2000, the Commission emphasized that the purpose of the arrangement is to reduce costs and create value for VNG and its customers.²² VIGUA stated that VNG and Sequent have failed to show that their arrangement is superior to what a non-affiliated company offered to VNG and is not the product of an undue affiliate preference.²³ VIGUA requested a hearing on the merits and requested that the Commission deny approval of the proposed AMAA.²⁴

¹² Enspire Notice of Participation at 2.

¹³ *Id.*

¹⁴ *Id.* at 3.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Section 56-77 of the Code.

¹⁸ VIGUA Notice of Participation at 1.

¹⁹ *Id.* at 2.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*; See *Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte, In Re: Investigation of gas supply asset assignment and agency agreement between Virginia Natural Gas, Inc., and Sequent Management, L.P., f/k/a AGL Energy Services, Inc.*, Case No. PUE-2004-00111, 2005 S.C.C. Ann. Rep. 360, Order Approving Affiliate Agreements and Closing Investigation (Oct. 31, 2005) (discussing Case No. PUA-2000-00085).

²³ VIGUA Notice of Participation at 2.

²⁴ *Id.* at 4.

On January 22, 2019, Direct Energy Business Marketing, LLC (“Direct Energy”), filed a Notice of Participation and Request for Hearing (“Direct Energy Notice of Participation”). Direct Energy is a competitive service provider (“CSP”) licensed by the Commission to serve industrial and commercial customers in Virginia.²⁵ Direct Energy stated that it has a direct interest in this proceeding because of its business in the competitive gas market and because it participated in the RFP bidding process.²⁶ Direct Energy stated that it would “provide invaluable insight” that would allow the Commission to determine whether the AMAA is in the public interest.²⁷ Direct Energy requested that the Commission grant its request to participate as a respondent in this matter, and order an evidentiary hearing on VNG and Sequent’s request for approval of the proposed AMAA.²⁸

On January 22, 2019, Tenaska Marketing Ventures (“TMV”) filed a Notice of Participation and Request for Hearing (“TMV Notice of Participation”). TMV is the third largest North American natural gas marketer and an industry-leading provider of natural gas transportation and storage asset management services, with transportation assets over 8 billion cubic feet (“Bcf”)/day and storage capacity of over 22 Bcf/day under management during the winter of 2018-2019.²⁹ TMV was aware of the Commission’s June 2018 Order requiring VNG to conduct an RFP for gas supply and asset management services and that VNG was to “make an aggressive effort to ensure that the RFP dissemination and bidding process is robust.”³⁰ TMV is prepared to submit evidence that VNG failed to satisfy this requirement.³¹ As a participant in the RFP, TMV stated that it has “a concrete interest in the outcome of this proceeding.”³² TMV further stated VNG’s proposed arrangement with Sequent benefits the two affiliates at the expense of VNG’s customers and other participants, including TMV, in the natural gas market.³³ TMV requested a hearing for the Commission to determine whether the proposed AMAA is in the public interest and should be approved.³⁴

On January 23, 2019, VNG filed a Response in Opposition to Requests for Hearing (“VNG Response”). VNG stated the Commission should deny the Requests for Hearing.³⁵ In support of its Response, VNG stated four points. First, Enspire’s stated basis for seeking an evidentiary hearing was rejected following extensive litigation, audit, and investigation. The capacity release issues raised by Enspire were litigated in Case No. PUR-2017-00122, and were the subject of a thorough audit and investigation by Staff. VNG noted that Enspire later withdrew its request for a capacity release program in that proceeding and there is no compelling reason to re-litigate the same issues in this proceeding.³⁶ Second, there is no requirement to convene a formal evidentiary hearing under

²⁵ Direct Energy Notice of Participation at 2. Direct Energy is licensed to provide natural gas service to customers in the Washington Gas Light Company (“WGL”) and CGV service territories, and it serves customers in the City of Richmond utility service territory. Direct Energy is considering the economic feasibility of also serving customers in VNG’s service territory, which in large part, depends on the outcome of this proceeding. *Id.* at n.3.

²⁶ *Id.* at 3.

²⁷ *Id.*

²⁸ *Id.*

²⁹ TMV Notice of Participation at 2.

³⁰ June 2018 Order at 6.

³¹ TMV Notice of Participation at 4.

³² *Id.* at 5.

³³ *Id.* at 6.

³⁴ *Id.* at 8.

³⁵ VNG Response at 1.

³⁶ *Id.* at 5-7.

the Affiliates Act, and the informal filing of comments is appropriate to determine whether the proposed AMAA is in the public interest. VNG noted pursuant to § 56-84 of the Code, the Commission has the discretion to determine whether to conduct an informal or formal proceeding on an application for approval of an affiliates transaction. VNG further noted in *Sierra Club v. State Corporation Commission*,³⁷ the Supreme Court of Virginia rejected a party's assertion that it had the right to participate in a formal proceeding on an Affiliates Act matter concerning a utility's fuel procurement arrangements. VNG cited cases in which the Commission denied requests for a hearing on the basis that (i) a hearing was not necessary to address the issues raised by the requesting party; or (ii) a Commission proceeding was not the appropriate forum to address the issues raised by the requesting party. VNG argued the Requests for Hearing fail to acknowledge that the proposed AMAA that is the subject of this proceeding is the result of a competitive bidding process reviewed by Staff, and they disregard the results of Staff's audit of Sequent's compliance with its affiliate agreements. Additionally, none of the Requests for Hearing acknowledge the substantial benefits that have accrued to VNG's customers under the affiliate agreements.³⁸ Third, TMV's challenge to the RFP process, including the bidder qualification requirements, is not properly before the Commission in this Affiliates Act case. VNG argued a hearing is not necessary for the Commission to determine that the RFP was handled in a reasonable, appropriate, and non-discriminatory manner, and that the resulting proposed AMAA should be approved under the Affiliates Act because it is in the public interest. To the extent that a prospective bidder failed to meet the bidder qualification requirements, including the creditworthiness requirements and associated financial commitment requirements, the bid was non-conforming and was rejected. VNG argued modifying or waiving these requirements shifts financial risk from the asset manager to VNG and its customers, which is clearly not in the public interest.³⁹ Fourth, it is in the interest of VNG's customers to approve the proposed AMAA. VNG stated that it has no infrastructure in place to allow it to provide Sequent's services internally and it would not be cost-effective to perform those services internally. For that reason, it is imperative that the proposed AMAA be in place by April 1, 2019, to maintain seamless access to dependable, reliable, and affordable natural gas commodity and capacity to discharge its obligations as a public utility.⁴⁰ Finally, VNG requested that the Commission deny the Requests for Hearing and issue a procedural schedule providing for the filing of written comments and a Staff Report.⁴¹

On January 24, 2019, Enspire filed a Reply to VNG's Response ("Enspire Reply"), in which it noted the pleadings filed by Enspire and the other respondents raise key issues of disputed facts and disputed opinions that are central to the Commission's determinations in this matter whether VNG fulfilled its obligations under the Commission's June 2018 Order; whether VNG imposed unreasonable and discriminatory requirements on bidders during the RFP process; whether VNG discriminated in favor of its affiliate; whether VNG made a reasonable and non-discriminatory determination that Sequent was the winning bidder; whether the Commission should approve the proposed AMAA, should reject it, or should amend it; and whether the Commission should require VNG to conduct another RFP.⁴² Enspire outlined the key disputed facts and disputed opinions that it believes necessitate a formal evidentiary hearing for the Commission to decide whether the

³⁷ *Sierra Club v. State Corp. Comm'n*, Record No. 171550, unpublished opinion at 10 (Va. Aug. 9, 2018).

³⁸ VNG Response at 7-10.

³⁹ *Id.* at 11-13.

⁴⁰ *Id.* at 13.

⁴¹ *Id.* at 14.

⁴² Enspire Reply at 1-2.

proposed AMAA is in the public interest.⁴³ Enspire urged the Commission to schedule a formal hearing.⁴⁴

On January 24, 2019, Direct Energy filed a Reply to VNG's Response to Request for Hearing ("Direct Energy Reply"). In its Reply, Direct Energy addressed two issues. First, the Commission should conduct a hearing in this case to fulfill its statutory duty to determine that the proposed AMAA is in the public interest. Direct Energy participated in the RFP and it is prepared to submit evidence that approval of the proposed AMAA is not in the public interest. An evidentiary hearing is required to submit that evidence.⁴⁵ Second, if Direct Energy wants to raise issues that were discussed in Case No. PUR-2017-00122 regarding upstream capacity, but left unresolved in that case. The Chief Hearing Examiner's Report and the Commission's June 2018 Order are both silent regarding those issues.⁴⁶ Direct Energy urged the Commission to schedule an evidentiary hearing in this matter.⁴⁷

On January 24, 2019, TMV filed a Reply to VNG's Response to Request for Hearing ("TMV Reply"). In its Reply, TMV addressed two issues. First, TMV argued the Commission has the statutory obligation to determine that the proposed AMAA is in the public interest. To do that, the Commission must conduct an evidentiary hearing so that participants in the RFP, such as TMV, can expose how VNG conducted the RFP. Contrary to VNG's assertion that the RFP "was handled in a reasonable, appropriate, and non-discriminatory manner,"⁴⁸ TMV stated that its evidence would show otherwise.⁴⁹ Second, TMV addressed VNG's argument that concerns over the way in which the RFP was conducted should be addressed in a separate complaint proceeding. TMV countered the current proceeding should hear concerns about how VNG conducted the RFP because the Commission must determine whether the proposed AMAA that resulted from the RFP is in the public interest. TMV stated that it would submit evidence to show that the RFP process was flawed.⁵⁰ TMV renewed its request for an evidentiary hearing in this matter.⁵¹

By Hearing Examiner's Ruling entered on January 28, 2019, the Examiner found that the Notices of Participation filed by Enspire, VIGUA, Direct Energy, and TMV satisfied the requirements of Rule 5 VAC 5-20-80 B of the Commission's Rules of Practice and Procedure ("Rules") to participate as parties in this proceeding. The Examiner further identified the issues raised in this proceeding included whether the RFP met the requirements of the Commission's June 2018 Order, and whether the RFP was fair, impartial, and non-discriminatory. The issues could not be decided by relying solely on the RFP Report filed in Case No. PUR-2017-00122, and warranted the taking of evidence and a hearing. The Examiner found a hearing should be scheduled to determine whether the proposed AMAA is in the public interest.

⁴³ *Id.* at 2-3.

⁴⁴ *Id.* at 3.

⁴⁵ Direct Energy Reply at 2-3.

⁴⁶ *Id.* at 3.

⁴⁷ *Id.*

⁴⁸ VNG Response at 11.

⁴⁹ TMV Reply at 2-3.

⁵⁰ *Id.* at 3-4.

⁵¹ *Id.* at 4-5.

On February 15, 2019, VNG filed a Motion *in Limine* to Strike Portions of Direct Testimony of Mary Hensley and Orlando Magnani (“Motion to Strike”). In its Motion to Strike, VNG stated that portions of Enspire witness Hensley’s and Direct Energy witness Magnani’s testimony address whether VNG’s asset manager should be required to release excess capacity. VNG argued that all issues and arguments relating to capacity release were fully litigated among the same parties and decided in Case No. PUR-2017-00122 as part of the Commission’s approval of the current asset management agreement. VNG argued the doctrine of collateral estoppel precludes any attempt to re-litigate those issues in this proceeding. VNG moved to strike portions of Ms. Hensley’s and Mr. Magnani’s direct testimony as improper and irrelevant testimony in this proceeding.⁵²

On February 19, 2019, Enspire filed its Opposition to Motion *in Limine* of Virginia Natural Gas, Inc. (“Enspire Opposition”). Enspire noted that VNG was factually wrong in its Motion to Strike when it stated that “all issues and arguments related to capacity release were fully litigated and decided in [Case No. PUR-2017-00122].”⁵³ For this reason, Enspire argued the doctrine of collateral estoppel could not apply to the testimony of Ms. Hensley. Enspire further argued certain of the requirements for collateral estoppel to apply are not present with respect to Ms. Hensley’s testimony that VNG seeks to strike. For the foregoing reasons, Enspire urged the Commission to deny VNG’s Motion to Strike.⁵⁴

On February 19, 2019, Direct Energy also filed its Response to Motion to Strike Direct Energy Testimony (“Direct Energy Response”). Direct Energy argued VNG failed to satisfy the test for collateral estoppel set out in its Motion to Strike. Direct Energy addressed the requirements for collateral estoppel and found them lacking in this case. Direct Energy urged the Commission to deny VNG’s Motion to Strike.⁵⁵

At the hearing, the Hearing Examiner denied VNG’s Motion to Strike. He noted that it was unclear from the Commission’s June 2018 Order, and the Chief Hearing Examiner’s Findings and Recommendations adopted as part of that Order, whether the Commission decided the issues raised by Enspire and Direct Energy in Case No. PUR-2017-00122.⁵⁶

The evidentiary hearing was convened in a Commission Courtroom on February 21, 2019. Joseph K. Reid, III, Esquire, Elaine S. Ryan, Esquire, Lisa R. Crabtree, Esquire, and Andrea Garner, Esquire, with the law firm of McGuireWoods, LLP, appeared on behalf of the Applicants. Louis R. Monacell, Esquire, with the law firm of Christian & Barton, LLP, appeared on behalf of Enspire and VIGUA. Eric M. Page, Esquire, with the law firm of Eckert Seamans Cherin & Mellott, LLC, appeared on behalf of TMV and Direct Energy. William H. Chambliss, Esquire, and Andrea B. Macgill, Esquire, appeared on behalf of Staff.

⁵² Motion to Strike at 2-3.

⁵³ Enspire Opposition at 1-2.

⁵⁴ *Id.* at 1-3.

⁵⁵ Direct Energy Response at 2-5.

⁵⁶ Tr. at 8-9.

SUMMARY OF THE RECORD

Virginia Natural Gas and Sequent Energy Management Direct Testimony

The Applicants presented the testimony of Kenneth W. Yagelski, Managing Director of Gas Supply for AGL Services Company (“AGL Services”) and Southern Company Gas (“Southern Gas”). Mr. Yagelski is responsible for gas supply activities for Southern Gas’s distribution operations, which includes VNG. He testified in support of the Applicants’ request for Commission approval of an AMAA under which Sequent would continue to provide gas supply and asset management services to VNG. Specifically, his testimony: (i) described VNG’s RFP process that resulted in Sequent being selected as the gas supplier and asset manager for the proposed AMAA term beginning on April 1, 2019; and (ii) explained how customers would benefit from the proposed AMAA with Sequent.⁵⁷

Mr. Yagelski described the procedural history of the Joint Application, including the Commission’s directive in Case No. PUR-2017-00122 for the Company to conduct an RFP to select its next gas supplier and asset manager, for Staff to conduct an audit of compliance with the 2018 Agreements, and for VNG to file an RFP Report. Mr. Yagelski summarized Staff’s Audit Report, which found:

- (a) VNG and Sequent are operating in compliance with the AMAA and GPSA.
- (b) Sequent’s gas supply practices and pricing are compliant with the Logical Dispatch plan provisions described in the AMAA.
- (c) Staff found no evidence that VNG had contracted for too much storage capacity, violated any of the ratable fill obligations, or failed to have VNG’s storage filled at appropriate levels when necessary to meet the needs of firm customers.
- (d) Staff found no evidence that Sequent’s off-system sales and capacity release activity on VNG’s behalf was imprudent or deprived VNG’s customers of value.⁵⁸

Mr. Yagelski described how the Company developed the RFP process and the RFP Process Timeline to document and monitor the timely completion of the RFP. He described the four major components of the RFP process: (i) in response to the Company’s RFP advertisement, prospective bidders were requested to execute a non-disclosure agreement (“NDA”);⁵⁹ (ii) upon timely execution of the NDA, prospective bidders were provided with an RFP Bid Package and requested to execute a Bidder Qualification Requirements Certification;⁶⁰ (iii) upon timely submission of the certification, qualified prospective bidders were provided with a RFP Package;⁶¹ and (iv) the qualified prospective bidders were requested to submit their final RFP response. Mr. Yagelski

⁵⁷ Ex. 2, at 1-2.

⁵⁸ *Id.* at 3-5; Staff Audit Report at 2.

⁵⁹ All prospective bidders interested in receiving the RFP Bid Package executed the same NDA. Ex. 2, at 9.

⁶⁰ The RFP Bid Package contained (i) the VNG AMA assets list; (ii) the Bidder Qualification Requirements; and (iii) the Bidder Qualification Requirements Certification document. Ex. 2, at 9.

⁶¹ The Bidder Qualification Requirements included: (i) Key Components of the AMAA; (ii) Initial Credit Evaluation; (iii) Experience with Local Distribution Company (“LDC”) Asset Management; (iv) Experience with Asset Types; (v) Experience with Retail Marketers; and (vi) References. The RFP Package contained the following: (i) the RFP overview document; (ii) the proposed AMAA; (iii) the list of VNG AMA assets; (iv) the VNG AMA operational procedures; (v) the proposed Terms of the GPS; and (vi) a description of the net margin calculation. Ex. 2, at 10, 13-14.

described the efforts the Company took to ensure a robust dissemination of the RFP. This included running an advertisement in two consecutive Monday editions of S&P Global Platts' Gas Daily ("Gas Daily"). The natural gas industry considers Gas Daily to be the leading publication on natural gas markets, any prospective bidders for asset management services would be subscribers and regular readers. The advertisement resulted in 22 natural gas market participants responding to the RFP and requesting information on the RFP process. Mr. Yagelski detailed the importance of the NDA⁶² and Bidder Qualification Requirements⁶³ included in the RFP Bid Package and explained the Company's rationale for each.⁶⁴

Mr. Yagelski described the results of the RFP at each stage of the RFP process. The advertisement in Gas Daily generated interest from 22 natural gas market participants in the RFP. Of those, 21 prospective bidders received the NDA. NDAs were received from 15 bidders by the deadline. The six prospective bidders that did not return the NDA were not required to explain why. The Bidder Qualification Requirements package was sent to the remaining 15 prospective bidders and it was returned by three prospective bidders. The 12 prospective bidders that decided not to return the Bidder Qualification Requirements Certification were not required to explain why. Of the three qualified bidders that received the RFP Package, two bidders provided a response to the RFP by the deadline. The one qualified bidder that did not provide a response was not required to explain why.⁶⁵

Mr. Yagelski explained how VNG assessed the RFP responses. This included a thorough assessment of the two RFP responses to ensure the bids were compliant with the RFP requirements and met all necessary contractual provisions. In addition to a quantitative review of the minimum guaranteed value, VNG also considered the bidders' qualitative attributes. The assessment included follow-up discussions with the qualified bidders, as necessary, to thoroughly clarify their RFP response, and to review any proposed changes to the draft AMAA and GPS. Mr. Yagelski summarized the results of that assessment, the majority of which is confidential.⁶⁶

Mr. Yagelski explained the subsequent communications that occurred following the receipt of the two RFP responses from TMV and Sequent, and how Sequent ended up as the successful RFP bidder. Mr. Yagelski believes the RFP met the requirements of the Commission's June 2018 Order, and was conducted in a fair, impartial and non-discriminatory manner.⁶⁷

Finally, Mr. Yagelski described the VNG/Sequent affiliate relationship, including the Commission's prior approvals under the Affiliates Act.⁶⁸ With respect to the proposed AMAA, he

⁶² Ex. 2, at 9.

⁶³ *Id.* at 10-11. Specifically, Mr. Yagelski explained the standards for meeting the credit support requirements. VNG's corporate parent, Southern Gas, established the requirement for credit support to protect firm sales customers from an event where the asset manager defaults or otherwise fails to perform under the proposed AMAA. This requirement is based on VNG's actual experience with Enron Corporation, which was the Company's asset manager prior to Sequent when Enron declared bankruptcy on December 3, 2001, resulting in significant risk to their counterparties. The credit support requirement was determined by Southern Gas Risk Control and was the same amount for all bidders. Ex. 2, at 11-12.

⁶⁴ Ex. 2, at 6-14.

⁶⁵ *Id.* at 14-15.

⁶⁶ *Id.* at 15-16.

⁶⁷ *Id.* at 16-20.

⁶⁸ *Id.* at 21-22.

explained the importance of the services to be provided and the benefits to VNG's customers resulting from the arrangement with Sequent. Mr. Yagelski stressed the importance of having the proposed AMAA in place to ensure that VNG maintains seamless access to dependable, reliable, and affordable sources of natural gas supply and capacity.⁶⁹ Mr. Yagelski explained the value of the proposed AMAA to VNG's customers, noting that at the Commission's direction, the Company initiated the RFP process for the selection of its next gas procurement and asset manager, including sharing drafts of the RFP Bid Package and RFP Package with Staff prior to dissemination. He further explained why the Company is seeking approval of a two-year term of the AMAA and the ability to extend the term for an additional two years.⁷⁰ Mr. Yagelski is confident of Sequent's ability to perform under the proposed AMAA. Sequent has a long history of delivering value to VNG's customers under prior arrangements for gas procurement and asset management services. He believes the proposed AMAA that resulted from the robust and competitive RFP process is in the public interest and should be approved through March 31, 2022.⁷¹

Direct Energy Business Marketing Direct Testimony

Direct Energy presented the testimony of Orlando "Randy" Magnani, President of Rand Energy Consultants. He provides consulting services to natural gas marketers primarily related to operational and technical issues. Mr. Magnani's testimony addressed why the RFP process was flawed and why it was skewed in favor of Sequent, an affiliate. He also addressed why the asset manager should be required to release capacity that is not required to meet the needs of VNG's customers.⁷²

Mr. Magnani explained why the RFP process was flawed. The RFP contained several clauses not usually present in RFPs issued by a public utility, which are restrictive and usually favor an affiliate. The RFP called for the asset manager to act as an agent for the utility, essentially stepping into the shoes of the LDC and providing point to point service without the ability to maximize the value of the capacity. Mr. Magnani characterized this arrangement as unusual. He believes the better, and more common structure, is for the LDC to release its capacity to the asset manager, which allows the asset manager to use the capacity with more flexibility and to maximize its value. It also allows the asset manager to avoid violating the FERC shipper must have title regulations.⁷³

Mr. Magnani outlined his concerns with the RFP. The RFP contains a condition that VNG can terminate the agreement at any time for any reason, which Mr. Magnani stated is extremely rare except in government contracts. An affiliate would not be concerned with this condition, but a non-affiliate would be. In addition, the RFP states that the asset manager cannot participate in retail activity in VNG's service territory, which Mr. Magnani also stated is rare and favors an affiliate. Mr. Magnani believes the condition stifles competition for no good reason.⁷⁴

⁶⁹ *Id.* at 22-23.

⁷⁰ *Id.* at 24-26.

⁷¹ *Id.* at 26.

⁷² Ex. 4, at 1-3.

⁷³ *Id.* at 4.

⁷⁴ *Id.* at 4-5.

Mr. Magnani explained that Direct Energy initially intended to participate in the RFP, but found the certification of bidder qualification to contain onerous conditions, as discussed above, that VNG indicated were non-negotiable. He suggested that such conditions be removed in future RFPs.⁷⁵

Finally, Mr. Magnani discussed why the asset manager should be allowed to release excess capacity. He explained that released capacity is a transparent process that is governed by FERC. When direct sales are made, it is difficult, if not impossible, to determine what the margin is on the transaction because costs are not transparent. Mr. Magnani believes that Sequent has shut down the market by not releasing capacity in VNG's service territory making it impossible for gas marketers to compete. He recommended that the Commission establish a working group of interested parties to discuss the issue whether the asset manager should be required to release unused capacity.⁷⁶

Enspire Energy Direct Testimony

Enspire presented the testimony of Mary K. Hensley, President and Director of Marketing. She explained why the Commission should reject the proposed AMAA with Sequent, and explained why the next asset manager should post VNG's unneeded capacity for release, rather than insisting on "delivered sales" transactions.⁷⁷

Ms. Hensley stated VNG has not been open and transparent in describing the results of the RFP. Further, VNG did not have an impartial person or entity evaluate the final bids, including whether the credit support requirements were met. Ms. Hensley stated it was unreasonable for VNG to require TMV to post a letter of credit or cash deposit to meet the credit support requirements. The cost of providing a letter of credit or cash deposit would have made it unprofitable to be the asset manager.⁷⁸

Ms. Hensley believes Southern Gas and VNG were not acting in the best interests of VNG's customers because TMV offered the highest annual guaranteed minimum value to VNG's customers. She offered other mechanisms that would have satisfied VNG's credit support requirements. Ms. Hensley stated it is apparent from the RFP that only two variables were to be assessed between the final bidders: (i) the annual guaranteed minimum value offered; and (ii) how the bidder proposed to satisfy the credit support requirements.⁷⁹

Ms. Hensley summarized the bidding process and determined that the process did not meet the requirements of the Commission's June 2018 Order.⁸⁰

Ms. Hensley stated a positive aspect of the RFP was that the annual guaranteed minimum payment has increased significantly. She noted that in the past VNG's customers were shortchanged because of the "negotiations" between the two affiliates for any guaranteed minimum

⁷⁵ *Id.* at 6.

⁷⁶ *Id.* at 6-7.

⁷⁷ Ex. 5, at 1-2.

⁷⁸ *Id.* at 2-5.

⁷⁹ *Id.* at 5-7.

⁸⁰ *Id.* at 7-10.

value. Ms. Hensley recommended that the Commission require VNG to conduct an RFP for the award of all future asset management agreements.⁸¹

Ms. Hensley urged the Commission to reject the proposed AMAA, or in the alternative, extend the existing agreement for one year to allow VNG to conduct another RFP.⁸²

Ms. Hensley directed her testimony to the release of unneeded capacity. She stated VNG and Sequent have used Sequent's prior refusals to post and release unneeded capacity on the upstream pipelines' EBBs, and not conducting RFPs to award the AMAA to provide a lack of transparency as to the real value of VNG's unneeded capacity. Ms. Hensley believes the proposed AMAA undervalues the worth of managing and optimizing VNG's unneeded capacity, especially in a region that is highly capacity constrained.⁸³

Finally, Ms. Hensley explained the harm that results from VNG and Sequent circumventing the public capacity release mechanisms offered by the upstream pipeline companies by requiring parties to buy a bundled capacity and commodity product for delivery at VNG's city gate. Market participants are harmed because they are not provided an opportunity through the EBBs to bid fairly on available unneeded capacity assets. In addition, VNG's customers are harmed because there is no true test to determine whether VNG is returning fair market value to its customers on unneeded assets when making bundled sales. Enspire is not requesting that the Commission require VNG/Sequent to post all unneeded capacity on the EBBs, only as a condition of approval, that they agree to post 10-20% of its unneeded capacity.⁸⁴

Tenaska Marketing Ventures Direct Testimony

TMV presented the testimony of two witnesses: Troy M. Davis, Vice President of Marketing for TMV; and Mark D. Soulliere, Vice President, Credit Risk, for TMV.⁸⁵

In his direct testimony, Mr. Davis stated the facts would show that the RFP process was administered in a manner designed to retain Sequent as VNG's asset manager under the cover of obtaining a better bid from TMV, which was only disqualified after being subjected to an unreasonable and unsupportable collateral requirement that was imposed by VNG and its affiliate, Southern Gas. Mr. Davis believes the rejection of TMV's superior bid was not in the public interest.⁸⁶

Mr. Davis discussed TMV's communications with VNG prior to the submission of its bid in the RFP regarding TMV's creditworthiness and the satisfaction of the bidder requirements concerning creditworthiness. Mr. Davis indicated that in early discussions VNG stated that TMV's creditworthiness "would not be an issue," and that VNG/Southern Gas were aware of TMV's

⁸¹ *Id.* at 10-11.

⁸² *Id.* at 12. At the hearing, Ms. Hensley changed her recommendation from six months to one year. Tr. at 182.

⁸³ Ex. 5, at 13-14.

⁸⁴ *Id.* at 15-17.

⁸⁵ TMV is an affiliate of its two parent companies, Tenaska Energy, Inc. and Tenaska Energy Holdings, LLC (collectively, "Tenaska"). Tenaska is currently the 26th largest privately held company in the United States with over \$10.5 billion in annual revenue, and has a combined balance sheet that shows total balance sheet equity more than \$1.7 billion and \$0 in long-term debt. Ex. 6, at 1-2.

⁸⁶ Ex. 6, at 1-2.

creditworthiness generally, based on prior business dealings. TMV and its parent, Tenaska, are both privately held corporations. It was never mentioned that TMV might be subject to other credit requirements.⁸⁷

Mr. Davis detailed the submission of TMV's bid in the RFP, VNG's subsequent demands regarding TMV's financial ability as a condition to being awarded the proposed AMAA, and the subsequent involvement of Southern Gas. To address the creditworthiness requirement in the RFP Bid Package, VNG directed TMV to include a statement on its Bidder Qualification Requirements Certification. TMV complied. At the time, no one from VNG indicated that other credit requirements might be imposed and what those requirements might be. Mr. Davis discussed the initial results of the RFP and the requirement for alternative credit support. He expressed his concern that TMV had not included the additional monetary expense for the alternative credit support in its bid. TMV was informed that Southern Gas's Risk Control was requiring the alternative credit support. TMV offered various alternative forms of credit support which are widely accepted in the energy industry, each of which was rejected by VNG/Southern Gas.⁸⁸

Mr. Davis testified about the conclusion that could be drawn because of VNG/Southern Gas's actions related to the submission of TMV's bid. Based on its RFP experience, TMV believes that VNG/Southern Gas pre-selected Sequent to be the winning bidder from the outset. This is evidenced by the restrictive bidder requirements which dissuaded and precluded other asset managers from submitting a bid in the first place. Additional evidence of predetermination is found in the actions taken by VNG/Southern Gas, the timing of those actions, all of which led to the rejection of TMV's bid.⁸⁹

Mr. Davis discussed his experience with other RFPs conducted by other LDCs and how TMV's experience differed with VNG's RFP. He noted that all the other RFPs had one common element – they were all designed or structured to encourage as many bidders as possible. VNG's RFP seemed to be designed just the opposite by limiting the number of bidders who could submit a bid. Mr. Davis noted the restrictive NDA might have caused several bidders to drop out. In addition, the restriction that any prospective asset manager with an affiliation with a retail marketer operating behind VNG's city gate would not be considered limited the number of bidders. TMV believes this automatically excluded several companies that provide asset management services in the industry from the RFP process. Mr. Davis specifically addressed the creditworthiness requirement in the RFP and how it was designed to exclude TMV from submitting a bid. For this reason, TMV specifically inquired about the requirement. Mr. Davis addressed the alternative credit support and stated that it is highly unusual. In an asset management arrangement, it is the asset manager that faces the credit risk that the LDC customer would default on its payment obligation, since the asset manager is selling natural gas to the LDC customer under the arrangement. Mr. Davis concluded that the alternative credit requirement was designed to exclude prospective bidders.⁹⁰

⁸⁷ *Id.* at 2-4.

⁸⁸ *Id.* at 4-9.

⁸⁹ *Id.* at 9.

⁹⁰ *Id.* at 10-12.

Mr. Davis detailed TMV's experience in providing natural gas asset management services to other LDCs and how his company's management of these assets provides significant value to the LDCs and their customers. TMV provides asset management services to customers across the United States and Canada, including natural gas producers, U.S. liquefied natural gas exporters, power plants, municipalities, and LDCs. TMV has asset management arrangements totaling over 8 Bcf/day of natural gas transportation capacity and over 22 Bcf of storage capacity. Of its total asset management business, 25% is with regulated LDC customers, which include some of the largest names in the energy industry. TMV moves approximately 9.5 Bcf/day on 130 pipelines throughout North America and can deliver natural gas when and where it is needed. TMV manages risk conservatively and its commercial activities are backed by ample credit support. TMV's commercial activities are backed by Tenaska's \$1.7 billion equity balance sheet, and a \$1.5 billion revolving credit facility. Mr. Davis believes TMV's industry experience, financial stability, and capacity to handle large asset management arrangements offers a major advantage for TMV's LDC customers.⁹¹

Mr. Davis discussed how TMV's participation in the VNG RFP serves to enhance competition for the benefit of VNG's ratepayers. As part of the RFP, TMV prepared a bid that would be viewed as the best overall economic value for VNG and its customers. However, VNG's ratepayers will not achieve the benefits of the RFP because VNG/Southern Gas rejected TMV's bid due to an unreasonable, unnecessary, and unsupportable collateral requirement imposed on TMV by Southern Gas so that its affiliate, Sequent, would be awarded the proposed AMAA.⁹²

Finally, Mr. Davis compared the value received by VNG and its ratepayers from Sequent over the past 18 years and how that would differ from the value that VNG and its ratepayers would have received if TMV's bid had not been rejected. Based on his analysis, Mr. Davis believes that VNG and its ratepayers have been, and continue to be, grossly underpaid for their assets by Sequent.⁹³

In his direct testimony, Mr. Soulliere informed the Commission of the critical facts involving the RFP to select VNG's next gas procurement and asset manager for VNG's natural gas transportation and storage assets under the proposed AMAA for the period April 1, 2019, through March 31, 2022. Mr. Soulliere stated the facts would show that the RFP process was administered in a manner designed to retain the incumbent affiliate, Sequent, under the cover of obtaining a competitive, and better bid, from TMV, which was disqualified after being subjected to an unreasonable and unsupportable collateral requirement which was imposed by VNG/Southern Gas. Mr. Soulliere believes the rejection of TMV's superior bid by VNG was not in the public interest.⁹⁴

Mr. Soulliere described how he first became involved in TMV's participation in the RFP. He discussed the credit support requirements and the certification that TMV was required to provide regarding its or its guarantor's meeting certain minimum credit rating requirements. Mr. Soulliere discussed the footnote that was agreed to between TMV and VNG that was added to TMV's Bidder

⁹¹ *Id.* at 12-13.

⁹² *Id.* at 13.

⁹³ *Id.* at 14-15.

⁹⁴ Ex. 8, at 1-2.

Qualification Requirements Certification. TMV was nonetheless advised to submit a bid, and was not rejected at this point of the RFP process.⁹⁵

Mr. Soulliere described the communications TMV had with representatives of VNG and Sequent regarding TMV's credit worthiness. On December 7, 2018, Mr. Soulliere received a telephone call from Craig Fleming, Director of Credit Risk for Sequent, to discuss credit and collateral matters relating to the RFP. TMV and Sequent had been involved in other transactions, and in those transactions, Mr. Fleming held himself out as acting on behalf Sequent. Mr. Soulliere was surprised that a representative from a competing bidder was calling him about TMV's credit and collateral requirements.⁹⁶

Mr. Soulliere provided the details of the credit requirements that were being imposed on TMV. TMV would be given a zero (\$0) credit limit, absent meeting other creditworthiness requirements. Mr. Fleming did not offer any explanation for rejecting TMV's creditworthiness, except for citing the requirements of the RFP. Mr. Soulliere sought to determine the basis for the dollar amount of the other creditworthiness requirements, but was unable to do so. Mr. Fleming would not provide any information or calculations in support of the purported credit exposure to VNG. Mr. Soulliere discussed various alternative forms and amounts of collateral from TMV, which were rejected by Mr. Fleming subject to further discussions between Mr. Fleming and his boss.⁹⁷

Mr. Soulliere discussed the rejection by VNG/Southern Gas of multiple forms of credit support and collateral offered by TMV to satisfy the credit requirements of the RFP. He explained it is not typical in the industry for a utility to require the alternative creditworthiness that VNG was requiring in relation to an asset management agreement. TMV has entered into a myriad of arrangements with regulated LDCs like the proposed AMAA without being required to meet the alternative creditworthiness requirement required in this case, or any other form of collateral, other than occasionally a Tenaska parent guarantee. Mr. Soulliere offered to provide VNG/Southern Gas a guarantee from Tenaska, but this was rejected by Mr. Fleming. Mr. Soulliere noted other instances in the past in which Southern Gas affiliates have accepted a parent guarantee from Tenaska.⁹⁸

Mr. Soulliere discussed the other forms of credit support that were rejected by Mr. Fleming and VNG/Southern Gas. The first option was a trade credit insurance policy through Euler Hermes North America ("Euler Hermes"), a AA rated insurance company, that would cover VNG in the event TMV failed to pay any amounts or perform any obligations under the parties' proposed AMAA. The second option was an On-Demand Payment Bond ("Payment Bond"), which committed Euler Harris to pay within seven days of demand submitted by VNG. Mr. Soulliere explained that the insurance and bond options are both highly liquid and highly secured credit support instruments utilized in the natural gas industry and accepted by LDCs, other regulated entities, and Independent System Operators ("ISO"). Mr. Soulliere noted that VNG/Southern Gas initially rejected the trade credit insurance policy based on an inaccurate reading of the policy. The

⁹⁵ *Id.* at 3-4.

⁹⁶ *Id.* at 4.

⁹⁷ *Id.* at 5.

⁹⁸ *Id.* at 6.

policy insured VNG, not TMV, for credit risk associated with the proposed AMAA. Although the bidder documents indicated that other forms of collateral would be considered, VNG/Southern Gas unreasonably refused to consider other forms of collateral.⁹⁹

Mr. Soulliere described the additional discussions regarding the trade credit insurance policy. VNG/Southern Gas took the position that the trade credit insurance option was unacceptable because it was not a highly liquid form of collateral and it was rejected by VNG's parent, Southern Gas. Mr. Soulliere noted the rejection by Southern Gas/Sequent was contrary to their usual practice in the natural gas industry. TMV offered to pay the full price of the trade credit insurance policy to cover any credit risk VNG might have.¹⁰⁰

Mr. Soulliere confirmed that VNG/Southern Gas gave no reason for rejecting the Payment Bond option. He explained why such bonds are gaining acceptance in the natural gas industry.¹⁰¹

Mr. Soulliere confirmed that TMV offered to meet VNG/Southern Gas's requested alternative form of creditworthiness, but requested support for the amount to understand VNG's actual credit exposure under the asset management agreement, which VNG/Southern Gas refused to supply. TMV considered the actual amount to be considerably less than the amount demanded by VNG/Southern Gas. In the end, TMV could not justify the expense of the irrevocable letter of credit or the cash security.¹⁰²

It was not until this case was commenced that VNG provided in discovery the methodology for calculating the alternative form of creditworthiness. Mr. Soulliere believes the calculation is not a fair representation of what VNG's credit exposure to its asset manager would have been under the proposed AMAA. Mr. Soulliere addressed each of the three factors. First, since the asset manager would be selling gas to VNG under the proposed AMAA, the asset manager has the credit risk that VNG would not pay for the gas, not the other way around. Second, under the proposed AMAA, all the natural gas storage assets remain in VNG's name and VNG would retain title to all the natural gas inventory held in storage. Third, under the proposed AMAA, all the natural gas transportation assets remain in VNG's name and VNG is currently paying these charges to the applicable pipelines, and would continue to do so under the proposed AMAA. Based on his calculations, Mr. Soulliere determined VNG's actual credit exposure for the two-year term of the proposed AMAA was significantly less than the amount VNG/Southern Gas were demanding. In fact, VNG's credit exposure to TMV was almost twice the amount, leaving TMV as the only party with credit exposure under the proposed AMAA.¹⁰³

Virginia Industrial Gas Users Association Direct Testimony

VIGUA filed no testimony in this proceeding; however, its counsel did provide an opening statement and a closing argument.

⁹⁹ *Id.* at 7-8.

¹⁰⁰ *Id.* at 8.

¹⁰¹ *Id.* at 8-9.

¹⁰² *Id.* at 10-11.

¹⁰³ *Id.* at 11-14.

Commission Staff Direct Testimony

At the end of the first day of the hearing, Staff requested to withdraw its testimony and Staff Action Brief. The following day after the conclusion of VNG's rebuttal testimony, Staff renewed its request and the request was granted.

Virginia Natural Gas and Sequent Energy Management Rebuttal Testimony

VNG presented the rebuttal testimony of Grace Kolvereid, Senior Vice President and Comptroller for Southern Gas. She responded to the testimony of TMV witness Soulliere. Specifically, she addressed the credit support requirements included in the RFP. Ms. Kolvereid is responsible for managing credit risk for Southern Gas subsidiaries, and ensuring adherence to the company's Risk Management Policy and credit evaluation procedures.¹⁰⁴

Ms. Kolvereid testified that VNG's corporate parent, Southern Gas, established a requirement for credit support to protect VNG's firm sales customers from an event where the AMAA is terminated for reasons of default and the asset manager fails to perform its gas procurement responsibilities. Ms. Kolvereid stated the initial credit evaluation for the RFP **BEGIN CONFIDENTIAL**

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Ms. Kolvereid noted that standard collateral in the natural gas industry are instruments with high liquidity, such as letters of credit and cash.¹⁰⁵

Ms. Kolvereid explained why the parent guarantee offered by Tenaska was not sufficient collateral because **BEGIN CONFIDENTIAL**

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Ms. Kolvereid discussed the two alternative forms of collateral offered by TMV to meet the credit support requirement. She explained how trade credit insurance works, the deductible required under the policy, and the policy period. She also explained how the Payment Bond, which is also known as a surety bond, works. She stated that neither product meets the credit support requirement of the proposed AMAA because neither provides the same level of assurance and liquidity as a letter of credit or cash. In the event of default by the asset manager, VNG would need fully liquid collateral to provide the necessary cash to resolve the non-performance issue.¹⁰⁷

¹⁰⁴ Ex. 17, at 1-2.

¹⁰⁵ *Id.* at 2-4.

¹⁰⁶ *Id.* at 5-6.

¹⁰⁷ *Id.* at 6-8.

Finally, Ms. Kolvereid confirmed **BEGIN CONFIDENTIAL**

¹⁰⁸ **END CONFIDENTIAL**

In his rebuttal testimony, Mr. Yagelski responded to the testimonies of Staff witness Lee, Enspire witness Hensley, Direct Energy witness Magnani, and TMV witnesses Davis and Soulliere.¹⁰⁹

Mr. Yagelski addressed the RFP process, terms, and conditions. The RFP was divided into four major components: (i) in response to the RFP, prospective bidders were required to execute an NDA; (ii) upon timely execution of the NDA, prospective bidders were provided with an RFP Bid Package and requested to execute a Bidder Qualification Requirements Certification; (iii) upon timely submission of the certification, qualified bidders were provided with an RFP Package; and (iv) qualified bidders were requested to submit their final RFP response. Mr. Yagelski explained the purpose behind each of the components of the RFP. In sum, he believes the RFP process was robust, transparent, and open to participation by any qualified bidder. Mr. Yagelski explained that the RFP structure used by VNG is not unusual in the gas industry, and there was no evidence that it was onerous.¹¹⁰

Mr. Yagelski responded to TMV witness Davis's testimony regarding communications that took place between VNG and TMV during the RFP process. In the summer of 2018, he discussed TMV's ability to participate in the RFP with Mr. Davis. Mr. Yagelski explained that **BEGIN CONFIDENTIAL**

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CONFIDENTIAL Mr. Yagelski confirmed that he never communicated to Mr. Davis that TMV would not be subject to the RFP Bidder Qualification Requirements. Mr. Yagelski explained the requirement that TMV include a footnote in its Bidder Qualification Requirements Certification regarding **BEGIN CONFIDENTIAL**

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CONFIDENTIAL Mr. Yagelski stated there is no ambiguity in the RFP bid documents and if TMV did not understand those documents that is unfortunate for TMV, but it does not provide a basis for any action by the Commission. He confirmed that at no time did he state that the Bidder Qualification Requirements would be unilaterally waived for TMV.¹¹¹

Mr. Yagelski addressed the timing of when bidders were notified **BEGIN CONFIDENTIAL**

END CONFIDENTIAL Mr. Yagelski indicated this was communicated to all bidders via the RFP Bidder Qualifications in the RFP Bid Package, which was provided on October 8, 2018, rather than November 30, 2018, as claimed by TMV witness Davis. Mr. Yagelski demonstrated that the credit requirement in VNG's RFP is consistent with most industry standard contracts, including contracts to which TMV has been a party. He noted the Federal Energy

¹⁰⁸ *Id.* at 9.

¹⁰⁹ Ex. 18, at 1-2.

¹¹⁰ *Id.* at 5-7.

¹¹¹ *Id.* at 7-10.

Regulatory Commission ("FERC") Tariff for Columbia Gas Transmission, Columbia Gulf Transmission, Dominion Energy Transmission, and Transco Gas Pipeline include creditworthiness provisions like those used by VNG. Mr. Yagelski provided an example of the creditworthiness requirements in a TMV agreement with Nicor Gas Company, which is a common provision found in North American Energy Standards Board ("NAESB") contracts used throughout the natural gas industry.¹¹²

Mr. Yagelski explained the credit exposure faced by VNG, and ultimately its customers, with the proposed AMAA and why it is important to protect customers from such risk. Mr. Yagelski noted the proposed AMAA contemplates the asset manager taking control of VNG's natural gas transportation and storage assets. VNG is concerned that its assets might become encumbered and unavailable for its customers' benefit if the asset manager defaults. Given the exposure faced by VNG, Mr. Yagelski believes **BEGIN CONFIDENTIAL**

END CONFIDENTIAL might be conservative. Mr. Yagelski believes it would not be in the public interest to relax VNG's credit support requirement and expose its customers to more risk.¹¹³

Mr. Yagelski responded to Direct Energy witness Magnani's testimony regarding: (i) the asset manager being an agent of the LDC is highly unusual and provides no ability to maximize the value of capacity; (ii) compliance with FERC regulations that shipper must have title; (iii) the termination provisions of the proposed AMAA; and (iv) the restriction that the asset manager could not have an affiliate participate in retail activity in VNG's service territory. He provided examples of other LDCs and their arrangements with their assets managers. In addition, he confirmed that the proposed AMAA is in full compliance with FERC Order 636. All gas that would be sold by Sequent to third parties and delivered using VNG capacity is done in Sequent's capacity as agent for VNG. Mr. Yagelski explained the reasons behind the provision that the agreement could be terminated at any time, and provided an example of the Roanoke Gas AMAA with ConocoPhillips which provides for short notice termination. He noted the termination provision has been in VNG's AMAA since the inception of the agreement, which has been reviewed and approved by the Commission. Finally, Mr. Yagelski explained that the restriction regarding retail activities by an affiliate was included in the RFP because of testimony by Enspire witness Hensley in Case No. PUR-2017-00122, and concerns raised by others in the past, about a level playing field for all natural gas participants operating in VNG's service territory and avoids any potential for a perceived or real conflict of interest.¹¹⁴

Mr. Yagelski noted that TMV was **BEGIN CONFIDENTIAL**

END CONFIDENTIAL Mr. Yagelski stated that any assertion by TMV that VNG preselected Sequent to be the winning bidder from the beginning is false and not supported by the facts. In the end, TMV's bid was rejected **BEGIN CONFIDENTIAL**

END CONFIDENTIAL Mr. Yagelski stated Sequent was the winning bidder of a

¹¹² *Id.* at 10-13.

¹¹³ *Id.* at 13-14.

¹¹⁴ *Id.* at 14-17.

fair, impartial, and non-discriminatory RFP process because it offered the only qualifying and conforming bid.¹¹⁵

Mr. Yagelski responded to Enspire witness Hensley's testimony of bias among affiliates VNG and Southern Gas, and TMV witness Soulliere's testimony that he was "surprised" that an employee of Sequent was involved in the RFP process. He explained that VNG receives management services from an affiliate services company and this arrangement was approved by the Commission, most recently in Case No. PUR-2017-00093.¹¹⁶

Mr. Yagelski discussed why it is in the public interest to approve the proposed AMAA, as requested by VNG. He explained why the relief requested by Enspire witness Hensley to approve the proposed AMAA for six months and require VNG to conduct another RFP would be unreasonable and would introduce unnecessary risk to VNG's customers and result in lower optimization values. Mr. Yagelski noted generally the overall value that the AMAA has returned for VNG's customers has been well above the annual guaranteed minimum value. Lastly, Mr. Yagelski noted that all the previous AMAA's were subject to review and approval by the Commission.¹¹⁷

Finally, Mr. Yagelski addressed Enspire witness Hensley's and Direct Energy witness Magnani's recommendations regarding capacity release. Mr. Yagelski noted, as he had in prior proceedings, that delivered sales have been proven to produce greater value to VNG's customers that capacity releases.¹¹⁸

DISCUSSION

There were three issues raised in this case for a Commission decision: (i) whether the RFP was fair, impartial, and nondiscriminatory; (ii) whether the AMAA is in the public interest; and (iii) whether the Commission has the statutory or regulatory authority to grant the relief requested by Enspire and Direct Energy relating to an excess capacity release program.

Code of Virginia

Section 56-77 A of the Code provides:

[n]o contract or arrangement providing for the furnishing of management, supervisory, construction, engineering, accounting, legal, financial, or similar services, and no contract or arrangement for the purchase, sale, lease or exchange of any property, right or thing, other than those above enumerated, . . . shall be valid or effective unless and until it shall have been filed with and approved by the Commission. The Commission shall, after the filing of such a contract or arrangement, approve or disapprove the contract or arrangement

¹¹⁵ *Id.* at 17-19.

¹¹⁶ *Id.* at 20; *Application of Virginia Natural Gas, Inc. and AGL Services Company, For approval of a revised services agreement under Chapter 4 of Title 56 of the Code of Virginia*, Case No. PUR-2017-00093, Order (August 30, 2017).

¹¹⁷ *Ex.* 18, at 21-22.

¹¹⁸ *Id.* at 23-24.

within sixty days. The sixty-day period may be extended by Commission order for an additional period not to exceed thirty days. The contract or arrangement shall be deemed approved if the Commission fails to act within sixty days or any extended period ordered by the Commission. It shall be the duty of every public service company to file with the Commission a verified copy of any such contract or arrangement, regardless of the amount involved, and the general rule herein referred to shall remain in full force and effect as to all other public service companies.

The AMAA RFP

a. The Initial RFP Process

In its June 2018 Order, the Commission directed that VNG “make an aggressive effort to ensure that the RFP dissemination and bidding process is robust.”¹¹⁹

As discussed in Mr. Yagelski’s testimony, VNG developed the RFP process and widely advertised the proposed AMAA in Gas Daily.¹²⁰ He summarized the initial results of the RFP.¹²¹ The advertisement in Gas Daily generated interest from 22 natural gas market participants. One prospective bidder responded past the initial deadline and was eliminated. VNG sent its NDA to 21 prospective bidders and received NDAs from 15 bidders by the deadline. Although the six bidders that did not return the NDA were not required to explain why, complaints were raised in this proceeding that the NDA had terms that were onerous and that might have deterred participation, making the RFP less robust.¹²² VNG absolutely refused to negotiate any of the terms of the NDA. For example, the NDA had a term of five years, the standard in the industry is three years, and the initial term of the proposed AMAA is two years. VNG’s refusal to negotiate any of the terms of the NDA could have been a contributing factor in the decisions to not return the NDA.¹²³

The Bidder Qualification Requirements package was sent to the remaining 15 bidders and it was returned by three prospective bidders. Although the bidders that did not return the Bidder Qualification Requirements Certification were not required to explain why, VNG imposed a restriction that **BEGIN CONFIDENTIAL**

¹²⁴ **END CONFIDENTIAL** VNG offered no persuasive reasons for including this restriction in the RFP. First, VNG tried to claim that it included this restriction in the RFP based on the position taken by Enspire witness Hensley in Case No. PUR-2017-00122.¹²⁵ In her testimony, Enspire witness Hensley drew a distinction between the market conduct concerns raised in Case No. PUR-2017-00122, in which VNG,

¹¹⁹ June 2018 Order at 6. From the Commission’s Order, the Hearing Examiner inferred that the RFP should also be fair, impartial, and non-discriminatory. See Hearing Examiner’s Ruling, Case No. PUR-2018-00203 at 6 (January 28, 2019).

¹²⁰ Ex. 2, at 6-14.

¹²¹ *Id.* at 14-15.

¹²² Tr. at 194-195, 203-204.

¹²³ Tr. at 204, 270-271.

¹²⁴ Ex. 2, at Confidential Schedule 1, p.72.

¹²⁵ Ex. 18, at 17.

Sequent, and Compass were all affiliated.¹²⁶ In that case, there was evidence that Sequent had provided preferential pricing to Compass. In the current case, Ms. Hensley would not have the same concerns if VNG and its asset manager were not affiliated, but the asset manager had an affiliate operating behind VNG's city gate. If VNG and its asset manager were not affiliated, Ms. Hensley believes VNG would be able to police the activities of its agent asset manager in the market.¹²⁷ Second, VNG claimed that the restriction was included to ensure a level playing field for all natural gas participants operating in VNG's service territory and to avoid any potential for a perceived or real conflict of interest.¹²⁸ In his testimony, Mr. Magnani stated there is no conflict of interest if an asset manager participates in retail activity.¹²⁹ The asset manager and its retail affiliate are no more likely to collude and engage in unacceptable market conduct than VNG and Sequent are likely to collude and engage in unacceptable market conduct.¹³⁰ Mr. Magnani noted that Direct Energy manages 55 AMAAs for LDCs and no one else has such a restriction in their agreement. In most of those jurisdictions, Direct Energy competes against itself.¹³¹ While Mr. Yagelski indicated that some of the 12 bidders that dropped out indicated to him that the deal was too large for them to undertake or offered other reasons,¹³² the city gate restriction was one of the reasons why Direct Energy chose not to participate in the RFP.¹³³ The number of other market participants that were similarly excluded from participating in the RFP may be determined by reviewing Confidential Exhibit 7 of the RFP Report and comparing the list of bidders with a list of CSPs licensed by the Commission to operate in VNG's service territory.¹³⁴

Three bidders submitted the Bidder Qualification Requirements Certification. At this point, it appears that VNG gave Sequent a competitive advantage in the RFP by accepting Sequent's parental guarantee offered by its affiliate, Southern Gas,¹³⁵ but requiring all other bidders to provide other credit support. A parental guarantee comes at no cost; all the other credit support requirements have a cost associated with them. In the case of an irrevocable letter of credit, that cost is substantial.¹³⁶ Knowing VNG's credit support requirement in advance was material to the submission of a bid in the RFP.

¹²⁶ At the time, Compass was a retail affiliate of VNG and Sequent and it operated behind VNG's city gate.

¹²⁷ Tr. at 188-191. Ms. Hensley noted there are several large asset managers in the region that have one or two customers behind VNG's city gate and, under the terms of the RFP, they would have been precluded from submitting a bid. Those asset managers included: BP, Constellation, UGI Energy Services, Washington Gas Energy Services, Colonial, and Stand. Tr. at 189-190.

¹²⁸ Ex. 18, at 17.

¹²⁹ Tr. at 150-151.

¹³⁰ *Id.*

¹³¹ *Id.* at 156-157, 160.

¹³² *Id.* at 384-386.

¹³³ Ex. 4, at 6.

¹³⁴ The third qualified bidder did not submit a bid. Pursuant to the terms of the Bidder Qualification Requirements, the third qualified bidder was precluded from submitting a bid because it has an affiliate operating behind VNG's city gate.

¹³⁵ TMV witness Soulliere testified that Southern Gas has \$8.6 billion of equity; however, its tangible net worth is only \$3.6 billion because it has \$5 billion of goodwill on its balance sheet. Southern Gas also has \$9.5 billion of long-term debt on its balance sheet. By comparison, Tenaska has \$1.7 billion in equity and zero (\$0) long-term debt on its balance sheet. Tr. at 290-291.

¹³⁶ **BEGIN CONFIDENTIAL**

END CONFIDENTIAL Ex. 8,

at 10.

b. Bidder Qualification Requirements

The Bidder Qualification Requirements included:

To qualify for receipt of the confidential portion of the RFP package (containing form agreements and detailed information regarding VNG's assets and asset utilization), an officer of the company representing the Bidder must certify its satisfaction of, and in the case of the items specified in No. 1, its acceptance of, the following qualification requirements. . . .

1. Key Components of Asset Management and Agency Agreement ("AMAA"). Bidder accepts the following non-negotiable terms of the VNG asset management arrangement:

. . .

- The asset manager must satisfy creditworthiness¹³⁷ requirements on an ongoing basis or provided appropriate and acceptable credit support, in this regard, asset manager or its guarantor's financial strength must support its ability to perform its obligations under the AMAA and GPSA, including without limitation the obligation to pay damages in the event of failure to perform. This assessment will be based on the commercially reasonable judgment of VNG and may require a financial commitment exceeding **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** If the asset manager or its guarantor does not meet this financial assessment, then a standby irrevocable letter of credit, issued by a United States commercial bank with at least \$10 billion in assets, and a Credit Rating of at least A- by S&P and A3 by Moody's, or other forms of collateral may be considered.

. . .

- 2. Initial Credit Evaluation.** Bidder will provide a copy of its or its guarantor's audited financial statements with notes for at least the past three years and its most recent quarterly report with management's discussion and analysis. Bidder will also provide documentation of its or its guarantor's current credit ratings from Moody's Investor Services, Inc. ("Moody's") and Standard and Poor's Financial Services, LLC ("S&P"). At a minimum, Bidder or its guarantor must have a Credit Rating (defined below) at or above BBB- by S&P and/or Baa3 by Moody's.¹³⁸

VNG's credit support requirements indicate that a prospective bidder could meet those requirements in one of three ways. First, on the strength of its financial statements and credit rating, a prospective bidder could provide a parental guarantee. The plain language of the Bidder Qualification Requirements requires that the "asset manager must satisfy creditworthiness requirements on an ongoing basis or [provide] appropriate and acceptable credit support."¹³⁹ Second, if a bidder does not meet the foregoing requirements, VNG may require a bidder to provide

¹³⁷ The term "creditworthiness" is not defined in the Bidder Qualification Requirements. Tr. at 107.

¹³⁸ Ex. 2, at Confidential Schedule 1, p.72-74.

¹³⁹ *Id.* at Confidential Schedule 1, p.73.

an irrevocable letter of credit in an amount specified by VNG.¹⁴⁰ Third, VNG may consider other forms of credit support offered by a prospective bidder.

TMV qualified as a bidder, notwithstanding the fact that **BEGIN CONFIDENTIAL**

END CONFIDENTIAL TMV received the confidential bid documents and was told that its lack of a **BEGIN CONFIDENTIAL**

END CONFIDENTIAL was not a problem and TMV was encouraged to submit a bid by VNG.

Based on the foregoing, after the three bidders submitted their Bidder Qualification Requirements Certification, and before the bids were to be submitted, VNG/Southern Gas would undertake an evaluation of the bidders' financial statements, and only after that evaluation, determine what level of credit support would be required. VNG/Southern Gas would use its "commercially reasonable judgement" to make this determination. In determining a prospective bidder's creditworthiness, the strength of the bidder's and its guarantor's financial statements, rather than the guarantor's credit rating, should have been determinative of whether a parental guarantee should be accepted. As noted at the hearing, both Enron and Pacific Gas & Electric Company had investment grade credit ratings in the weeks leading up to their respective bankruptcies.¹⁴¹ However, VNG/Southern Gas had already decided that TMV did not meet the creditworthiness requirements, that no parental guarantee would be accepted from Tenaska because Tenaska did not have a **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** even though Southern Gas has accepted Tenaska parental guarantees in the past,¹⁴² and that TMV would have to provide an irrevocable letter of credit to satisfy the AMAA creditworthiness requirements.¹⁴³

On or about November 21, 2018, Craig Fleming, who is technically an employee of AGL Services, but who holds himself out professionally as the Director of Credit Risk for Sequent,¹⁴⁴ provided a final bidder risk analysis to Chris Bellinger, an employee of Southern Gas who had overall responsibility for the RFP.¹⁴⁵ The final risk analysis assessed the credit risk of TMV and the other bidder in the RFP, and did not address the credit risk of Sequent.¹⁴⁶ In his direct testimony, TMV witness Soulliere indicated that he and Mr. Fleming have been involved in other transactions

¹⁴⁰ Whether the amount specified by VNG is reasonable to cover its actual credit risk will be addressed later in this report.

¹⁴¹ Tr. at 117-118, 285-286.

¹⁴² TMV witness Davis confirmed that Southern Company, and its affiliates, have never rejected a Tenaska parental guarantee as proof of creditworthiness. Mr. Davis testified that he has participated in hundreds of RFPs while employed at TMV, and not once was TMV or Tenaska deemed uncreditworthy. Mr. Davis confirmed that TMV and Tenaska have never defaulted on a contractual obligation. Tr. at 208-209, 225. TMV witness Soulliere testified that TMV has over \$80 million in parental guarantees issued to Southern Company. Mr. Soulliere confirmed that once or twice over the past 22 years a Tenaska parental guarantee was not accepted, but in those instances, other credit support was accepted. Tr. at 321-322.

¹⁴³ Tr. at 108-115. TMV witness Davis testified that at no time prior to the submission of TMV's bid was TMV advised by VNG that any parental guarantee offered by Tenaska would be rejected because **BEGIN CONFIDENTIAL**

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¹⁴⁴ Tr. at 338; Ex. 12.

¹⁴⁵ Ex. 9C.

¹⁴⁶ *Id.*

throughout the years, and during that time, Mr. Fleming has held himself out as acting on behalf of Sequent. Mr. Soulliere was surprised on December 7, 2018, when Mr. Fleming, a representative of a competing bidder, called him after TMV was awarded the bid to discuss TMV's credit and collateral requirements.¹⁴⁷ At the hearing, Mr. Soulliere indicated that Mr. Fleming's office is in Houston, Texas, in the same offices as Sequent.¹⁴⁸ At best, this is evidence of an apparent conflict of interest, and at worst, this is evidence of an actual conflict of interest. It appears to be the latter, rather than the former. VNG/Southern Gas sought to rehabilitate this damaging evidence by stating that Southern Company has processes and procedures in place to prevent services company employees from having conflicts of interest in any RFPs. VNG/Southern Gas failed to show how Southern Company's processes and procedures were applied in this case. VNG/Southern Gas also sought to claim that Mr. Fleming's LinkedIn page was out-of-date and had not been updated in some time. Mr. Fleming's LinkedIn page indicates that he is the Director, Credit Risk, for Sequent Energy Management, and he started his employment with Sequent Energy Management in "June 2006 – Present · 12 yrs 9 mos."¹⁴⁹ As of February 1, 2019 (12 years and 9 months from June 2006), Mr. Fleming was still holding himself out professionally as the Director of Credit Risk for Sequent Energy Management.

c. The TMV Award

On the afternoon of Friday, December 7, 2018, Chris Bellinger, Manager of Gas Supply for Southern Gas, notified TMV witness Davis by e-mail that TMV was the winning bidder and it would be awarded the proposed AMAA **BEGIN CONFIDENTIAL**

¹⁵⁰ **END CONFIDENTIAL** On Saturday afternoon, December 8, 2018, Mr. Fleming sent an e-mail to TMV witness Soulliere indicating that as they had discussed the previous day, Mr. Fleming's **BEGIN CONFIDENTIAL**

¹⁵² **END**

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d. Post-Award Credit Support Requirement

From Monday, December 10, 2018, through Friday, December 14, 2018, TMV sought to resolve the issue of credit support with VNG/Southern Gas. Early Monday morning, December 10, 2018, TMV witness Soulliere sent Mr. Fleming an e-mail requesting information and support **BEGIN CONFIDENTIAL**

¹⁵³ **END**

¹⁴⁷ Ex. 8, at 4.

¹⁴⁸ Tr. at 324-325.

¹⁴⁹ Ex. 12.

¹⁵⁰ Ex. 2, at Confidential Schedule 3, p.2. Also on December 7, 2018, VNG/Southern Gas notified Sequent that they had selected another company for the proposed AMAA. *Id.* at Confidential Schedule 4, p.2.

¹⁵¹ As shown in Ex 9C, Mr. Fleming was more involved in TMV's credit support determination than just collecting TMV's credit support.

¹⁵² Ex. 2, at Confidential Schedule 3, p.5.

¹⁵³ *Id.* at Confidential Schedule 3, p.7.

CONFIDENTIAL Later the same morning, VNG witness Yagelski responded by e-mail addressing Mr. Soulliere's request **BEGIN CONFIDENTIAL**

¹⁵⁴ **END CONFIDENTIAL**

Late in the afternoon of Tuesday, December 11, 2018, Mr. Soulliere sent Mr. Yagelski an e-mail indicating that **BEGIN CONFIDENTIAL**

¹⁵⁵ **END CONFIDENTIAL**

In a series of e-mails on Monday, December 10, 2018, and Tuesday, December 11, 2018, Mr. Fleming sought to explain to Mr. Soulliere how **BEGIN CONFIDENTIAL**

¹⁵⁶ **END**

CONFIDENTIAL In other words, TMV was told that because **BEGIN CONFIDENTIAL**
END CONFIDENTIAL TMV had to provide an irrevocable letter of credit as credit support.

After business hours on Tuesday, December 11, 2018, Mr. Yagelski sent Mr. Soulliere an e-mail advising TMV that VNG/Southern Gas had reviewed **BEGIN CONFIDENTIAL**

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at Confidential Schedule 3, p.10. Enspire witness Hensley testified that Enspire also uses Euler Hermes because it is one of the top-rated credit insurance companies in the world. Enspire has \$250 million in lines of credit with Euler Hermes. Tr. at 196. TMV witness Soulliere testified that in many ways a credit insurance policy is superior to a parental guarantee because an independent third party with substantial financial backing would be there to pay any potential claim. Mr. Soulliere noted that any parental guarantee issued by Enron to Enron Trading & Marketing would have been worthless when Enron declared bankruptcy. Tr. at 292-293. Mr. Soulliere confirmed that TMV owns a policy issued by Euler Hermes. Tr. at 321.

¹⁵⁶ Ex. 2, at Confidential Schedule 3, p.14-15.

¹⁵⁷ **END CONFIDENTIAL**

The morning of December 12, 2018, Mr. Soulliere sent Mr. Yagelski an e-mail clarifying several points about **BEGIN CONFIDENTIAL**

¹⁵⁸ **END CONFIDENTIAL**

The following morning on December 13, 2018, Mr. Yagelski sent Mr. Soulliere an e-mail **BEGIN CONFIDENTIAL**

¹⁵⁹ **END CONFIDENTIAL** Approximately an hour later, Mr. Yagelski sent Mr. Soulliere another e-mail **BEGIN CONFIDENTIAL**

¹⁶⁰ **END CONFIDENTIAL**

e. The Sequent Award

At approximately 5:00 p.m. on December 14, 2018, VNG provided the proposed AMAA documents to Sequent to execute.¹⁶¹

f. The Amount of Credit Support

No one would dispute the fact that VNG needs to have a credit support requirement and the amount of credit support needs to be sufficient to cover the risk faced by VNG in the event of default by its asset manager. VNG's credit support requirement is unreasonable and does not represent the risk faced by VNG. VNG points to the fact that 19 years ago Enron was its asset

¹⁵⁷ *Id.* at Confidential Schedule 3, p.20-21. The Bidder Qualification Requirements state that "other forms of collateral may be considered" without any limitations.

¹⁵⁸ *Id.* at Confidential Schedule 3, p.19-20. TMV witness Soulliere testified that he worked with members of the International Energy Credit Association ("IECA"), of which he was president in 2013, to develop the performance bond product. The product was designed to act like a letter of credit to satisfy the requirements of regulated entities and ISOs. A performance bond is widely accepted because it is both liquid and flexible to ensure timely and certain payment. Mr. Soulliere noted that companies such as TransCanada and Kinder Morgan accept performance bonds. Tr. at 298-299.

¹⁵⁹ Ex. 2, at Confidential Schedule 3, p.19-20.

¹⁶⁰ *Id.* at Confidential Schedule 3, p.25.

¹⁶¹ *Id.* at Confidential Schedule 4, p.4.

manager and VNG negotiated its way out of the asset management contract days before Enron declared bankruptcy. Fortunately for VNG, its actual exposure to Enron's bankruptcy was negligible.¹⁶² This does not appear to support the amount VNG claims as credit support in this case.

VNG determined the amount of its credit support as follows: **BEGIN CONFIDENTIAL**

¹⁶³ **END**

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TMV noted that regarding the first factor, under the proposed AMAA the asset manager sells gas to VNG, and VNG must pay the asset manager for delivered gas. Consequently, the asset manager would have this level of credit exposure to VNG, not vice versa. Regarding the second factor, under the proposed AMAA, VNG retains ownership of its storage assets and would continue to receive all inventory reports from its storage providers and can monitor its storage inventories. In addition, VNG retains title to the natural gas held in storage. TMV cannot sell storage gas to a third party without VNG's consent. Finally, under the proposed AMAA, all the natural gas transportation assets remain in VNG's name and are not released to the asset manager. VNG currently pays any demand charges to the applicable pipelines and would continue to do so under the proposed AMAA. TMV witness Soulliere calculated VNG's credit risk during the two-year term of the proposed AMAA to be **BEGIN CONFIDENTIAL**

END CONFIDENTIAL At the end of the day, Mr. Soulliere believes TMV is the only party with credit exposure under the proposed AMAA.¹⁶⁴

At the hearing, VNG tried to claim that a credit support requirement is supported by NAESB contracts used throughout the natural gas industry. However, these contracts also provide for offsetting the credit risk of the counterparties.¹⁶⁵ Additionally, it was established that VNG's actual credit risk is the difference between the price that the asset manager would have charged VNG for gas and the price VNG would have to pay on the open market for gas. Enspire witness Hensley

¹⁶² Tr. at 115.

¹⁶³ Ex. 8C, at 11-12. If the inputs supported by Respondents' testimony are included in VNG's credit support formula, the amount of credit support would not exceed **BEGIN CONFIDENTIAL**

END CONFIDENTIAL Ex. 8, at 11-14.

¹⁶⁴ Ex. 8, at 11-14.

¹⁶⁵ Tr. at 287-288. TMV witness Soulliere testified that the NAESB standard form contract provides that in addition to a letter of credit, credit support may be provided by a performance bond or a parental guarantee. The NAESB contract also leaves it open to the parties to agree upon other forms of credit support.

indicated that there is plenty of natural gas supply, the issue is moving the gas, and VNG continues to control its capacity under the proposed AMAA.¹⁶⁶

I find the RFP was not fair, impartial, and non-discriminatory. First, VNG withheld information that would have been material to the submission of the bids by TMV and the other bidder, other than Sequent. To withhold this information was unfair and favored Sequent in the RFP process. VNG had already determined to accept a parental guarantee from Sequent's affiliate, Southern Gas. This placed the other two bidders at a competitive disadvantage without having VNG's actual credit support requirements before they submitted their bids. Second, the participation of Mr. Fleming in the evaluation of the credit risk of TMV and the other bidder, other than Sequent, presented a conflict of interest and compromised the impartiality of the RFP process. Finally, VNG discriminated against TMV by failing to evaluate fairly its credit risk based on the financial statements provided by TMV and by establishing a credit support requirement in the RFP that was unsupported by VNG's actual credit exposure. The standard in the natural gas industry for credit support appears to be that counterparties offset their respective credit risks.¹⁶⁷

Asset Management and Agency Agreement

The RFP demonstrated two points. First, VNG's customers benefitted from having the AMAA competitively bid. Second, the fair market value of the annual guaranteed minimum payment under the AMAA is significantly higher than the amount paid by Sequent in the past.

An asset management agreement has been in effect between VNG and Sequent for 18 years. For the first eight years of the agreement, there were **BEGIN CONFIDENTIAL**
END CONFIDENTIAL The annual guaranteed minimum payment began **BEGIN CONFIDENTIAL**

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During the life of the agreement, the AMAA returned **BEGIN CONFIDENTIAL**
END
CONFIDENTIAL to VNG and its customers. During the same period, the AMAA generated **BEGIN CONFIDENTIAL**
END CONFIDENTIAL for Sequent.¹⁶⁸

VNG initially accepted TMV's bid, but as discussed above, rejected the bid in favor of Sequent's bid. TMV's bid provided for **BEGIN CONFIDENTIAL**

¹⁶⁹ **END**

¹⁶⁶ Tr. at 198-201. Enspire witness Hensley testified that the difference in VNG's gas cost would be approximately \$1 per dth. The commodity price of gas has moved about \$1 over the last couple of years. Ms. Hensley also explained that VNG's calculation of the gas cost in its credit support requirement is flawed. The price quoted by VNG includes two components: (i) the commodity price for the gas which was trading at \$2.90 for the upcoming winter; and (ii) the transportation cost to move the gas. Since VNG retains ownership of its transportation assets, Ms. Hensley stated VNG has no exposure for any transportation costs. VNG's only risk exposure would be if the \$2.90 NYMEX price increased to \$3.50 or \$4.00.

¹⁶⁷ Tr. at 287-288.

¹⁶⁸ This assumes the revenue sharing percentage was consistent throughout the period of the AMAA. See Ex. 5, at Confidential Attachment C, p.26.

¹⁶⁹ As part of its bid, TMV also offered **BEGIN CONFIDENTIAL**

CONFIDENTIAL Sequent's bid provided for **BEGIN CONFIDENTIAL**

END CONFIDENTIAL difference between the two bids is not inconsequential. Over the four-year life of the proposed AMAA, VNG and its customers would **BEGIN CONFIDENTIAL** **END**

CONFIDENTIAL On its face, TMV's bid appeared to be far superior to Sequent's bid. In the first two years under TMV's bid, VNG and its customers would receive more in annual guaranteed minimum payments, than they received during the previous 18 years the AMAA between VNG and Sequent has been in effect.

VNG believes the proposed AMAA resulted from a robust and competitive RFP process, the proposed AMAA is in the public interest, and the proposed AMAA should be approved by the Commission.¹⁷⁰

Enspire believes Southern Gas and VNG were not acting in the best interests of VNG's customers when they selected Sequent's bid over TMV's bid. TMV's bid offered the highest annual guaranteed minimum payment to VNG's customers.¹⁷¹ Enspire believes a positive aspect of the RFP process was that the annual guaranteed minimum payment increased significantly because of competitive bidding. Enspire believes VNG's customers were shortchanged over the years as result of the "negotiations" that took place between the two affiliates for any guaranteed minimum payments. Enspire recommended that the Commission deny the Joint Application, or in the alternative, extend the current AMAA for one year and require VNG to conduct another RFP.¹⁷²

Tenaska believes its participation in the RFP served to enhance competition for the benefit of VNG's ratepayers. TMV prepared a bid that would be viewed as the best overall economic value for VNG and its customers.¹⁷³ Based on TMV's analysis, VNG and its ratepayers have been, and continue to be, grossly underpaid for their assets by Sequent.¹⁷⁴ At the hearing, TMV stated that it is ready, willing, and able to assume its duties as VNG's asset manager and gas supplier.¹⁷⁵

For the reasons stated above relating to the annual guaranteed minimum payment, the proposed AMAA does not appear to be in the best interests of VNG and its customers. If approved as requested, VNG's customers would pay significantly more for natural gas service over the next four years than they otherwise would have paid, if the RFP was conducted in a fair, impartial, and non-discriminatory manner. To be fair, the proposed AMAA is better than the agreement VNG/Sequent currently have, but it is far inferior to the agreement VNG/TMV could have had. Based on the evidence in the record, I find the proposed AMAA between VNG and Sequent is not in the public interest.

END CONFIDENTIAL Ex. 6, at Confidential

Attachment 1, p.1.

¹⁷⁰ Ex. 2, at 26.

¹⁷¹ Ex. 5, at 5-7.

¹⁷² *Id.* at 10-12.

¹⁷³ Ex. 6, at 13.

¹⁷⁴ *Id.* at 14-15.

¹⁷⁵ Tr. at 213-214.

Excess Capacity Release Program

This issue is a carryover from Case No. PUR-2017-00122. In that case, Enspire requested that the Commission direct Sequent, as VNG's agent, or VNG to post the capacity portion of a delivered sales transaction before the deal was finalized with respect to sales terms of one month or greater and volumes of 300 dth/day or greater. Enspire asserted that excess capacity releases were possible, and that VNG had unneeded capacity that it could release to other natural gas marketers. However, Staff witness Johnson testified that the impact of capacity releases should be looked at from the perspective of VNG's entire portfolio, and the impact on the entire portfolio most likely would be negative. Based on that testimony, Enspire withdrew its request that the Commission direct VNG and Sequent to adopt Enspire witness Hensley's recommended capacity release program.¹⁷⁶

In the alternative, Enspire requested that the Commission consider adding two additional requirements to the asset management agreement in that case. First, Enspire recommended a requirement that would prohibit the asset manager from offering different preferential pricing terms for delivered sales transactions. Enspire pointed to past instances in which Sequent provided lower prices to Compass, an affiliate at the time. Second, Enspire proposed an additional requirement to direct VNG to develop a complaint process whereby retail gas marketers could lodge a complaint if they determined that VNG's asset manager was providing preferential delivery services, either in terms of pricing or some other aspect of the transaction. Enspire recommended an informal and formal complaint procedure.¹⁷⁷

Direct Energy continued to assert that a capacity release program was important, and the best way to ensure an open and competitive market was to have VNG release capacity associated with the customer's load so that a marketer could serve that customer. Direct Energy suggested that the Commission convene a collaborative process with interested stakeholders to discuss the feasibility of potential capacity release measures in VNG's service territory. Direct Energy proposed a process for the working group, and indicated that the process would not interfere with any future RFP.¹⁷⁸

Staff raised concerns that requiring capacity releases might lower the value or limit the number of responses to an RFP. In response to Direct Energy's suggestion that a collaborative process should be required, Staff stated that time was of the essence to fully address the current application, and the RFP should proceed expeditiously.¹⁷⁹

VNG and Sequent stated that their delivered sales practice was intended to optimize the portfolio based on current market conditions, and that third-party sales deliver greater value than the capacity release that Enspire had initially advocated. VNG and Sequent also asserted that market conditions could change and in the future capacity releases could become more attractive.¹⁸⁰

¹⁷⁶ Report of Deborah V. Ellenberg, Chief Hearing Examiner, Case No. PUR-2017-00122, at 19 (May 29, 2018).

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 19-20.

¹⁷⁹ *Id.* at 20.

¹⁸⁰ *Id.*

The Chief Hearing Examiner determined that the capacity release program advocated by Direct Energy was outside the scope of the current proceeding. She further found the record did not support the development of the capacity release program at that time. She preferred to allow the RFP process to run its course, and to later see whether the successful bidder wanted to include a capacity release program as part of its services. In her findings and recommendations, the Chief Hearing Examiner found, among other things, that: “. . . (3) Staff should be directed to conduct an audit of compliance with the gas supply and asset management agreements between VNG and Sequent, and an investigation of such other conduct related to performance under those agreements as Staff deems warranted; and (4) A capacity release program need not be developed in conjunction with this proceeding.”¹⁸¹

Both Enspire and Direct Energy filed comments to the Chief Hearing Examiner’s Report. In its comments, Enspire continued to assert that under the VNG/Sequent arrangement Sequent ships natural gas that it owns using pipeline capacity owned by VNG. Since VNG does not release the capacity assets to Sequent, Enspire stated this arrangement violates FERC shipper must have title requirements. Enspire urged the Commission to require VNG to release its capacity to its next asset manager.¹⁸² In its comments, Direct Energy urged the Commission to direct VNG and interested parties to implement a collaborative process to determine an appropriate capacity release program to allow CSPs in VNG’s service territory to provide robust competition contemplated by the General Assembly.¹⁸³

In its June 2018 Order, the Commission adopted the findings and recommendations of the Chief Hearing Examiner, except as modified in its Order. The issues of a capacity release program, a complaint process, and a working group were clearly before the Commission. The Commission did not specifically deny the relief requested by Enspire and Direct Energy. However, one could infer that the Commission decided that a capacity release program need not be developed in conjunction with an Affiliates Act case. The Commission: (i) agreed that an RFP process was in the public interest, that VNG should initiate such a process, and that VNG should file a report on the RFP; (ii) found that the term of the 2018 Agreements should not extend beyond March 31, 2019; (iii) agreed that Staff should conduct an audit of compliance with the gas supply and asset management agreements between VNG and Sequent, and an investigation of such other conduct related to performance under those agreements, as Staff deems warranted; and (iv) kept the docket open to receive the reports required by its Order.¹⁸⁴

Staff filed its Audit Report on October 15, 2018. In addition to the requirements set forth in the Commission’s Order, Staff (i) evaluated compliance with the Agreements, including examination of virtual dispatch, off-system sales, storage arbitrage, and allocation methods/revenue sharing mechanism; (ii) audited selected transactions that were highlighted during the evidentiary hearing and sampled various transactions as warranted; and (iii) looked at the services and

¹⁸¹ *Id.*

¹⁸² Comments of Enspire Energy, LLC to Report of Deborah V. Ellenberg, Chief Hearing Examiner, Case No. PUR-2017-00122, at 7 (June 12, 2018).

¹⁸³ Comments of Direct Energy Business Marketing, LLC to Report of Deborah V. Ellenberg, Chief Hearing Examiner, Case No. PUR-2017-00122, at 13 (June 13, 2018).

¹⁸⁴ June 2018 Order at 4-5.

transactions provided by Sequent, reviewed Sequent's financial and operational risk management policies, and reviewed Sequent's internal controls.¹⁸⁵

Based on the audit results, Staff concluded:

- (a) VNG and Sequent are operating in compliance with the AMAA and GPSA.
- (b) Sequent's gas supply practices and pricing are compliant with the Logical Dispatch plan provisions described in the AMAA.
- ...
- (d) Staff found no evidence that Sequent's off-system sales and capacity release activity on VNG's behalf was impudent or deprived VNG's customers of value.¹⁸⁶

In this proceeding, Enspire witness Hensley stated the VNG and Sequent have used Sequent's prior refusal to release unneeded capacity and the direct negotiations between the parties for the AMAA to provide a lack of transparency of the real value of VNG's unneeded capacity. Ms. Hensley believes the proposed AMAA undervalues VNG's unneeded capacity, especially in a region that is highly capacity constrained.¹⁸⁷ Ms. Hensley explained the harm that results from VNG and Sequent circumventing the capacity release mechanisms offered by upstream pipeline companies. Market participants are harmed because they are not provided an opportunity through the EBBs to bid fairly on unneeded capacity assets. VNG's customers are harmed because there is no true test to determine whether VNG is returning fair market value to its customers on unneeded assets when making bundled sales. In terms of relief, Enspire requested, as condition of approval of the proposed AMAA, that the Commission require VNG/Sequent to post 10-20% of its unneeded capacity on the EBBs.¹⁸⁸

Direct Energy witness Magnani explained that released capacity is a transparent process that is governed by FERC, and direct sales of a bundled product, capacity and gas, for delivery at VNG's city gate is not transparent. He believes Sequent has shut down the market in VNG's service territory making it impossible for gas marketers to compete. He renewed Direct Energy's request that the Commission establish a working group to study the issue whether VNG's asset manager should be required to release unused capacity.¹⁸⁹

I am unsure whether the Commission has the statutory or regulatory authority to grant the relief requested by Enspire. Capacity release programs are governed by extensive regulations adopted by FERC.¹⁹⁰ In this Affiliates Act case, Enspire has argued that a business practice is harming its customers, and therefore, the practice is not in the public interest. Other than general allegations of harm included in its pleadings, Enspire has not cited any instance in which one of its customers paid more for a bundled sale, and by how much, than what the customer otherwise would have paid if it was a capacity-only sale and Enspire provided the commodity gas. Enspire has not established that any of its customers were actually harmed by VNG/Sequent's bundled sales

¹⁸⁵ Staff Audit Report at 1-2.

¹⁸⁶ *Id.* at 2.

¹⁸⁷ Ex. 5, at 13-14.

¹⁸⁸ *Id.* at 15-17.

¹⁸⁹ Ex. 4, at 6-7.

¹⁹⁰ FERC has adopted extensive regulations governing capacity release markets. *See* FERC Order No. 712 (June 19, 2008), 18 C.F.R. § 284.8.

practice. I find that Enspire did not meet its evidentiary burden of proving that VNG/Sequent's off-system sales practices actually harm its customers.

If the alternative is litigation at FERC, Direct Energy's requested relief is a holistic approach to resolving the issue of off-system sales without having to resort to litigation that is costly for all parties, including VNG and its customers. Direct Energy's proposal merits consideration by the Commission.

To be clear, the duty of VNG's asset manager is to maximize the value of VNG's assets for the benefit of VNG and its customers, nothing else. The asset manager is not responsible for ensuring that a competitive natural gas market exists in VNG's service territory. The asset manager's performance under the proposed AMAA should be judged on whether it maximized the value of VNG's assets. To evaluate that performance, sufficient records must be maintained to show that the asset manager maximized the value of off-system sales, whether those were bundled sales or capacity-only sales. The records maintained by the asset manager should be in sufficient detail for Staff to audit all off-system sales. I recommend, as a condition of approval of the proposed AMAA, that the Commission require the asset manager to retain sufficient records of its off-system sales for Staff to determine in an audit whether the asset manager maximized the value of those sales for the benefit of VNG and its customers.

Remedies

At the hearing VNG witness Yagelski was asked if the Commission disapproved the Joint Application, what options were available to VNG. Mr. Yagelski stated there would be insufficient time to get another asset manager in place. VNG would have to find someone who would provide the gas purchase and sale function only. Two other options would be to extend the current AMAA for one year, or approve the proposed AMAA for a year. VNG would not award the proposed AMAA to TMV, unless TMV provided adequate credit support.¹⁹¹

The option that provides the least monetary benefit to VNG and its customers would be a gas purchase and sale contract for one year. Under the current AMAA, VNG and its customers receive **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** in annual guaranteed minimum payments and a percentage of asset optimization that has averaged **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** per year over the life of the AMAA.¹⁹² Under a gas purchase and sale agreement, VNG and its customers would receive \$0. VNG witness Yagelski stated that VNG would be challenged to find a party that would be willing to enter a gas purchase and sale contract.¹⁹³

The second option for VNG and its customers would be to extend the current AMAA for one year. Under the proposed AMAA with Sequent, VNG and its customers would receive **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** in annual guaranteed minimum payments and a percentage of asset optimization which has averaged **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** per year over the life of the AMAA. Under

¹⁹¹ Tr. at 119-121.

¹⁹² Ex. 5, at Confidential Attachment C, p.26.

¹⁹³ Tr. at 139-140.

the current AMAA, VNG and its customers would lose **BEGIN CONFIDENTIAL**
END CONFIDENTIAL in annual guaranteed minimum payments. Mr. Yagelski was unsure whether Sequent would accept this option.¹⁹⁴

The third option for VNG and its customers would be to approve the proposed AMAA with Sequent for a period of one year. This option mitigates the lost revenues to VNG and its customers to the greatest extent practicable without awarding the proposed AMAA to TMV. Under this option VNG and its customers would lose **BEGIN CONFIDENTIAL** **END**
CONFIDENTIAL in annual guaranteed minimum payments. The proposed AMAA with Sequent provides **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** in annual guaranteed minimum payments, while the agreement with TMV would have provided **BEGIN**
CONFIDENTIAL **END CONFIDENTIAL** in annual guaranteed minimum payments. Mr. Yagelski was unsure whether Sequent would accept this option.¹⁹⁵

TMV witness Davis stated that TMV is ready, willing, and able to become VNG's asset manager commencing April 1, 2019. TMV and VNG have already negotiated contracts that are final, and TMV is prepared to execute those contracts. Upon execution, TMV is prepared to deliver a parental guarantee commensurate with VNG's actual exposure under the AMAA.¹⁹⁶

VNG does not believe the Commission has the authority to order VNG to accept TMV's bid. However, VNG does not dispute that the Commission has the authority to deny the Joint Application for not being in the public interest, and the Commission has the authority to deny the other options discussed above for not being in the public interest. If VNG enters the proposed AMAA with TMV, no Commission approval would be required because VNG and TMV are not affiliates.

As a closing comment, the evidentiary record supports denial of the Joint Application, or in the alternative, approval of the proposed AMAA for a period of one year and a requirement that VNG conduct another RFP for the AMAA.

FINDINGS AND RECOMMENDATIONS

Based on the evidence received in this case and for the reasons set forth above, I find that:

- (1) The RFP was not fair, impartial, and non-discriminatory;
- (2) The proposed AMAA is not in the public interest;
- (3) The Joint Application should be denied, or in the alternative, the proposed AMAA should be approved for a period of one year and VNG should be required to conduct another RFP for the AMAA;

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Id.* at 213-214.

- (4) If the Commission adopts the alternative proposed above, an independent market monitor should be required to manage the next RFP on behalf of VNG and report the results of the RFP to the Commission;¹⁹⁷
- (5) Enspire did not meet its evidentiary burden of proving that VNG/Sequent's off-system sales practices actually harm its customers; and
- (6) Direct Energy's excess capacity working group proposal merits consideration by the Commission.

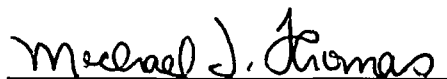
Accordingly, I **RECOMMEND** the Commission enter an order:

- (1) **ADOPTING** the findings in this Report;
- (2) **DENYING** the Joint Application, or in the alternative, **APPROVING** the Joint Application for a period of one year and requiring VNG to conduct another RFP for the AMAA; and
- (3) **PASSING** the papers herein to the file for ended causes.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within five (5) calendar days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,



Michael D. Thomas
Senior Hearing Examiner

The Clerk of the Commission is requested to send a copy of this Report to all persons on the official Service List in this matter. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, VA 23219.

¹⁹⁷ Enspire witness Hensley recommended that to ensure broad participation in any future RFP, the Commission should require that the RFP be conducted by an independent market monitor. She believes the only reason why market participants would agree to respond to another RFP is if the process is overseen by someone who is truly independent. Tr. at 192-193.