126 FERC ¶ 61,042
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

National Fuel Marketing Company, LLC
NFM Midstream, LLC
NFM Texas Pipeline, LLC
NFM Texas Gathering, LLC

Docket No. IN09-10-000

ORDER TO SHOW CAUSE AND NOTICE OF PROPOSED PENALTIES

(Issued January 15, 2009)

1. Pursuant to section 385.209(a)(2) of the Commission's regulations,[1] the Commission's *Revised Policy Statement on Enforcement*,[2] and the Commission's *Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties*,[3] the Commission directs the above-captioned firms (collectively, Respondents) to show cause why they should not be found to have violated section 1c.1 of the Commission's regulations,[4] which prohibits the manipulation of natural gas markets, and why they have not violated the Commission's "shipper-must-have-title" requirement. The Commission further directs the Respondents to show cause why they should not be assessed civil penalties as specified in the attached Enforcement Staff Report and Recommendation dated December 31, 2008 (OE Staff Report)[5] in the amount of $4,500,000 and required to

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[1] 18 C.F.R. § 385.209(a)(2) (2008).

[2] 123 FERC ¶ 61,156, at P 35-36 (2008).

[3] 117 FERC ¶ 61,317, at P 7 (2006).

[4] 18 C.F.R. §1c.1 (2008) (Anti-Manipulation Rule).

disgorge any payment received from entities settling enforcement investigations arising from the bidding for interstate transportation capacity on the Cheyenne Plains Gas Pipeline Company LLC (Cheyenne) pipeline during its March 2007 open season. The Commission directs the Respondents to file such answers with the Commission within 30 days of the date of this order.

2. This case presents allegations by the Commission's Office of Enforcement Staff (OE Staff) of violations of the Commission's Anti-Manipulation Rule and its "shipper-must-have-title" requirement. These allegations and the potential civil penalties and disgorgement amounts noted above arose out of an investigation conducted by OE Staff and are described in the OE Staff Report. The OE Staff Report alleges that National Fuel Marketing Company, LLC (National Fuel) used its subsidiary affiliates, NFM Midstream, LLC, NFM Texas Pipeline, LLC, and NFM Texas Gathering, LLC, to obtain a larger allocation of interstate transportation capacity on Cheyenne's pipeline than National Fuel could have acquired by itself. The OE Staff Report alleges that the affiliates themselves had no use for the Cheyenne capacity, but instead used the capacity they obtained to transport gas belonging to National Fuel, thereby violating the Commission's "shipper-must-have-title" requirement.

3. Based on the allegations contained in the OE Staff Report, the Commission orders the Respondents to respond to this order as set forth above.[6] Following submission of Respondents' answers, the Commission will determine how to proceed. It may issue an order on the merits, request briefs or set specified issues for a trial-type hearing with full discovery before an ALJ, request a recommendation or report from an ALJ, or provide for any other process that would justly and efficiently resolve the matter. The Commission also will determine the amount of any penalties and disgorgement, if appropriate.

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[5] The OE Staff Report is attached to this order as Appendix A. The OE Staff Report describes the background of OE Staff's investigation, proposed findings of fact and conclusions of law, and proposed sanctions. OE Staff asks the Commission to issue a show cause order making the OE Staff Report public and to reserve judgment on whether to set the matter for an evidentiary hearing before an Administrative Law Judge (ALJ).

[6] Under the applicable rule, 18 C.F.R. § 385.213(c) (2008), Respondents must file answers that provide a clear and concise statement regarding any disputed factual issues and any law upon which they rely. Respondents must also, to the extent practicable, admit or deny, specifically and in detail, each material allegation contained in the OE Report and set forth every defense relied upon.

The Commission orders:

(A) Within 30 days of the date of this order, Respondents must file answers in accordance with 18 C.F.R. § 385.213 (2008) showing cause why they should not be found to have (1) violated section 1c.1 of the Commission's regulations, and (2) violated the Commission's "shipper-must-have-title" requirement.

(B) Within 30 days of the date of this order, Respondents must file answers in accordance with 18 C.F.R. § 385.213 (2008) showing cause why their alleged violations of section 1c.1 of the Commission's regulations and the Commission's "shipper-must-have-title" requirement should not warrant the assessment of civil penalties in the amount of $4,500,000 and require them to disgorge any payment received from entities settling enforcement investigations of bidding on Cheyenne in March 2007.

(C) In any answer, Respondents should address any matter, legal, factual or procedural, that they would urge in the Commission's consideration of this matter.

(D) Within 30 days of the filing of the answers by the Respondents, Enforcement Litigation Staff may file a reply with the Commission.

By the Commission. Commissioner Moeller dissenting with a separate a statement attached.

(S E A L) Commissioner Spitzer dissenting with a separate statement to be issued at a later date.

Kimberly D. Bose,
Secretary.

FEDERAL ENERGY REGULATORY COMMISSION

National Fuel Marketing Company, LLC
NFM Midstream, LLC
NFM Texas Pipeline, LLC
NFM Texas Gathering, LLC

Enforcement Staff Report and Recommendation

Office of Enforcement
Division of Investigations

Docket No. IN09-10-000 December 31, 2008

The Office of Enforcement (OE or Enforcement) reports to the Federal Energy Regulatory Commission (Commission) its findings of fact and conclusions of law regarding National Fuel Marketing Company, LLC, and its affiliates, NFM Midstream, LLC (NFM Midstream), NFM Texas Pipeline, LLC (NFM Texas Pipeline), and NFM Texas Gathering, LLC (NFM Texas Gathering) (together, the NFM entities) bidding for, and transactions related to, interstate natural gas transportation capacity on Cheyenne Plains Gas Pipeline Company, LLC (Cheyenne) on March 13, 2007.[1]

I. Executive Summary

Based on the report that follows, Enforcement recommends that the Commission issue an Order To Show Cause to the NFM entities requiring them to show cause why they did not violate Commission regulations in connection with their bidding for, and use of, interstate natural gas transportation capacity on Cheyenne, and why they should not pay a civil penalty and be subject to disgorgement of unjust profits.

Enforcement investigated the conduct of a number of companies that bid for capacity in an open season conducted by Cheyenne in March 2007. At that time, there was a substantial difference in the price of natural gas in Wyoming and at mid-continent markets due to limited pipeline capacity between the two areas. Capacity on Cheyenne, which connects Wyoming production areas to mid-continent markets, was therefore very valuable and in high demand.

On March 6, 2007, Cheyenne posted an open season notice inviting bids for unsubscribed, seasonal capacity available for the months of April, May, September and October 2007 (designated by Cheyenne as the "UAC 3 open season"). The notice provided that, in the event there is not enough capacity to satisfy demand, Cheyenne would allocate the capacity *pro rata* to all of the bidders who valued the capacity at the highest allowable net present value (NPV) – that is, to bidders seeking all of the available capacity, throughout the entire term, and at the maximum Cheyenne FERC Gas Tariff rate.

On March 13, 2007, Cheyenne received 48 bids, including four from NFM, a privately-held natural gas marketing company, and three of its subsidiaries. All bids were at the highest allowable NPV. On March 14, 2007, Cheyenne notified NFM that it and its three subsidiaries were among the "winning" bidders, and as such, the four NFM entities each were awarded a *pro rata* allocation of the available capacity.

[1] NFM and its subsidiaries are not affiliated with National Fuel Gas Company of Williamsville, NY.

Acting on complaints received from other market participants, Enforcement investigated the bidding on Cheyenne. The complaints were that some bidders submitted multiple bids through affiliated companies in order to game the *pro rata* allocation, that is, to obtain multiple shares of valuable capacity at the expense of market participants who submitted only a single bid. Enforcement's investigation sought to determine whether any bidders violated Cheyenne's FERC Gas Tariff or any of the Commission's rules or regulations. Among the bidders investigated were the NFM entities.[2]

As explained in this report, Enforcement staff determined that NFM used its subsidiaries NFM Midstream, NFM Texas Gathering, and NFM Texas Pipeline, to submit bids to Cheyenne for the purpose of securing a larger allocation of scarce and valuable Cheyenne capacity than NFM could acquire by itself. NFM's subsidiaries did not have a use for the Cheyenne capacity for their own needs, but instead used the capacity they obtained to transport gas belonging to NFM.

During the course of Enforcement's investigation, staff determined, among other things, that:

- NFM's purpose in having bids submitted by its three subsidiaries was to acquire more capacity for NFM than it could acquire for itself;
- NFM decided to submit multiple bids after conducting a comprehensive economic analysis that showed the additional profits expected as a result of receiving multiple shares of capacity;
- Documents contemporaneous with the bidding on Cheyenne demonstrate that NFM acted deliberately and intentionally to game Cheyenne's *pro rata* allocation mechanism;
- NFM's President and its CFO and Treasurer were kept apprised of the plan to submit multiple bids, and specifically approved the submission of multiple bids;
- NFM's CFO and Treasurer testified under oath that the intent of the NFM Midstream, NFM Texas Gathering, and NFM Texas Pipeline bids was to secure more capacity for NFM; and

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[2] Simultaneous with this report, Enforcement staff is also submitting a report recommending an Order To Show Cause with respect to the bidding for Cheyenne capacity by Seminole Energy Services, LLC, and its affiliates. In addition, staff is submitting four settlements of bidding activity by other companies for the Commission's consideration. Those companies are: Tenaska Marketing Ventures and its affiliates (Tenaska); ONEOK Energy Services Co. and its affiliates (ONEOK), Klabzuba Oil & Gas, FLP (Klabzuba); Jefferson Energy Trading Co., LLC (Jetco); Wizco, Inc. (Wizco); and, Golden Stone Resources, LLC (Golden Stone).

- Upon award of the capacity, NFM held title to the gas that its subsidiaries transported for it on Cheyenne.

The issue of multiple affiliate bidding in an open season has arisen before. In 2002, staff investigated multiple bids by affiliates in two open seasons on Trailblazer Pipeline Company LLC (Trailblazer). In the course of that investigation, staff caused a notice to be posted by Trailblazer that staff was monitoring auctions where multiple bids could be used "to game auctions of released capacity" when *pro rata* allocation was used as the tie-breaker. In 2005, the Commission expressed its concern with abuse of open seasons for valuable capacity:

> Finally, the Commission takes note of Calpine's requests regarding limitations on the amount of capacity bid and multiple bids from affiliates. Although we are not prohibiting all such bids, we will examine closely any such bids to determine whether they are soundly based on satisfying the legitimate needs of the bidder, or whether they are made to "game" the open season process.[3]

At the time of the Trailblazer bidding, the Commission had broad anti-discrimination authority under the Natural Gas Act (NGA), but lacked anti-manipulation authority. As Trailblazer had followed its procedures and had not engaged in undue discrimination, the Commission took no action on staff's investigation. In 2005, however, the Commission was granted broad anti-manipulation authority by the Energy Policy Act of 2005 (EPAct 2005)[4] and the Commission promptly implemented that authority in Order No. 670,[5] placing all market participants on notice that fraudulent conduct is prohibited.

As the Commission recognized in Order No. 2005, not all multiple-affiliate bids

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[3] *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, Order No. 2005, FERC Stats. & Regs., ¶ 31,174 at P 99 (2005). While many aspects of the prospective transportation of Alaskan natural gas are unique to those circumstances, the Commission's caution on abuse of open season bidding can be applied to any circumstance in which valuable capacity is offered to prospective shippers.

[4] *Energy Policy Act of 2005*, Pub. L. No. 109-58, 119 Stat. 594 (2005).

[5] *Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. 31,202 (2006). The anti-manipulation rules adopted by the Commission applicable to natural gas transactions are codified at 18 C.F.R. § 1c.1 (2008).

constitute gaming. Consistent with this approach, Enforcement considered the purpose for which bidders sought Cheyenne capacity and only pursued sanctions for companies that subverted the open season process. Staff also considered the holding of *Transcontinental Gas Pipe Line Corp. v. FERC*, 998 F.2d 1313, 1321 (5th Cir. 1993) (*Transco*). In *Transco*, the court held that where the statutory purpose of the NGA could be easily frustrated through the use of separate corporate entities, the Commission is correct to look through the corporate form and treat the separate entities as one and the same for purposes of regulation.

With respect to NFM, staff concluded that NFM's subsidiaries had no separate or legitimate need or use for the Cheyenne capacity, and that they were acting as a single entity within the meaning of *Transco*.

Staff then examined whether NFM's conduct in submitting bids by its subsidiaries, and then using that capacity to transport gas owned by NFM, violated section 1c.1. A violation of section 1c.1 requires that an entity: (1) use or employ a fraudulent device, scheme or artifice, or engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity, (2) with scienter, and (3) in connection with a transaction subject to the jurisdiction of the Commission. Staff found no violations of Cheyenne's FERC Gas Tariff by NFM bidding on Cheyenne.

Staff concluded that NFM's use of bids by its subsidiaries was a device, scheme, or artifice to defraud the other Cheyenne open season bidders. Given the sealed, single opportunity bid process used by Cheyenne, NFM's multiple affiliate bidding was also an act, practice, or course of business that operated as a fraud or deceit upon the other open season bidders. First, the facts establish that NFM and its subsidiaries acted as a single entity for the purpose of obtaining additional valuable capacity for NFM's benefit as compared to the amount NFM could obtain on its own. The bids by NFM's subsidiaries were not made to satisfy any legitimate needs of NFM Midstream, NFM Texas Gathering, or NFM Texas Pipeline. Rather, NFM orchestrated the actions by its subsidiaries to obtain more capacity for NFM at the expense of other open season bidders. Second, the facts also show that NFM acted with the intent to defeat the *pro rata* allocation mechanism – that is, that NFM acted deliberately and intentionally to obtain a greater share of valuable capacity than NFM was entitled to. In short, the conduct of the NFM entities meets the requirements of section 1c.1 and thus constitutes a "transaction for the purpose of impairing, obstructing or defeating a well-functioning market."[6]

In addition to the violation of section 1c.1, staff determined that NFM held title to the gas transported by its three subsidiaries using the capacity they acquired in the

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[6] Order No. 670 at P 50.

Cheyenne open season. The three NFM subsidiaries thus violated the Commission's "shipper-must-have-title" requirement. NFM's conduct also harmed numerous other Cheyenne bidders by reducing the allocation they received of scarce and valuable capacity. As the facts show, most bidders, including companies that are part of large corporate organizations and have multiple affiliates, submitted one bid. The awards to such bidders were reduced because of NFM's multiple bids.

In the course of the investigation, NFM was informed both orally and in writing of staff's views, and was invited to apprise staff of any misstatement of fact or error NFM may perceive in staff's understanding of the facts. Staff also afforded NFM the opportunity to present any alternate views or defenses. NFM did not dispute any material facts, but NFM disputed staff's interpretation of the facts and presented several arguments which it believes militate against enforcement action in this case. These arguments will be discussed below.

Staff engaged NFM in good faith settlement negotiations, but was unable to reach an agreement to resolve the investigation. On October 31, 2008, staff gave NFM written notice, pursuant to 18 C.F.R. § 1b.19 (2008), of staff's intent to recommend that the Commission issue an Order To Show Cause. NFM responded on December 5, 2008, and the response was forwarded to the Commission per section 1b.19.

For the reasons explained below, Enforcement staff recommends the Commission issue an Order To Show Cause why the NFM entities did not violate 18 C.F.R. §1c.1 and the Commission's "shipper-must-have-title" requirement in connection with the NFM entities' bids for, and transportation using, capacity acquired in the March 2007 Cheyenne open season, and why the Commission should not require the NFM entities to pay a civil penalty of $ 4,500,000 and to disgorge unjust profits, plus interest.[7]

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[7] NFM represents that it lost $28,553 in transactions using the Cheyenne capacity. While staff accepted NFM representations, staff notes that there are companies settling staff's investigation of bidding on Cheyenne that will disgorge unjust profits to the other Cheyenne open season bidders, including to the NFM entities. Accordingly, staff recommends the Commission order the NFM entities to show cause why they should not disgorge the payments they receive from settling companies, plus interest.

II. Background

A. Cheyenne Plains Open Season

Cheyenne, a subsidiary of El Paso Corporation, is a 380-mile long, 36-inch natural gas pipeline extending from the Cheyenne Hub, near the Wyoming-Colorado border, to south-central Kansas, with a total certificated capacity of 780,000 Dth/d. Cheyenne is an interstate pipeline regulated under Part 284 of the Commission's regulations. Cheyenne is one of only a few interstate natural gas pipelines transporting gas from the Rockies, where gas is plentiful, to markets in the Midwest, where natural gas is more highly valued.

On March 6, 2007, Cheyenne posted an open season notice for unsubscribed capacity available in the amounts of 70,000 Dth/d for April and October 2007, and 45,000 Dth/d for May and September 2007. The notice specified that Cheyenne would evaluate all open season bids based on the net present value or NPV of the monthly reservation charges for each bid consistent with section 21.5 of the General Terms and Conditions of Cheyenne's FERC Gas Tariff. In the event there was not sufficient capacity to meet all winning bids, Cheyenne stated in the notice of open season published on its Electronic Bulletin Board (EBB) that capacity would be allocated *pro rata* based on the maximum delivery quantity of the winning bids. The open season was a closed auction – that is, the bids and identities of the bidders were submitted under seal and only became known when Cheyenne posted the results of the open season on its EBB following the close of the open season on March 14, 2007.

The provision of Cheyenne's FERC Gas Tariff relevant to this open season is section 21.5 of the General Terms and Conditions. Section 21.5 provides Cheyenne's process for conducting open seasons for "uncontracted-for" capacity. The provision, in its entirety, states:

> Should Transporter conduct an open season, it will post a notice of availability of the uncontracted-for capacity on its EBB to afford all potential Shippers an opportunity to acquire the capacity. Any party wishing to purchase the capacity, and who meets Transporter's creditworthiness requirements, may participate in the open season. Transporter will award the capacity on a net present value basis using nondiscriminatory and objective posting and evaluation criteria specified in the notice of open season. When an open season is being conducted, all applicable requests for service will be treated under this open season process.

In March 2007, the difference between the price at which natural gas could be

bought at the Cheyenne Wyoming receipt points and sold at the Cheyenne Kansas delivery point significantly exceeded the transportation costs, which meant Cheyenne's capacity was valuable and in high demand. As a result, Cheyenne received 48 bids in its open season, which resulted in 47 winning bidders.[8] Each of these bidders submitted a bid at the highest allowable NPV, that is, for all of the available capacity, throughout the entire term, and at the maximum Tariff rate. Using its *pro rata* allocation mechanism, Cheyenne allocated each winning bidder 1,489 Dth/d for the April/October capacity and 957 Dth/d for the May/September capacity, which amounts to $1/47^{th}$ or 2.1% of the total available capacity.

B. Complaints to the Hotline from Market Participants

Shortly after the close of the March 2007 Cheyenne open season, staff received calls to the FERC Enforcement Hotline from winning bidders complaining that they had been defrauded. In total, staff received five complaints via the Hotline alleging that certain entities placed multiple bids through multiple affiliates for the available seasonal capacity offered by Cheyenne in the open season.

All of the callers alleged the same pattern of conduct: corporate entities placing multiple bids for the Cheyenne capacity through affiliates to obtain a larger share of capacity. Hotline callers characterized this conduct as "gaming" the *pro rata* allocation system employed by Cheyenne under its FERC Gas Tariff. The callers alleged that the intent of such multiple bidding is to capture an unfair and disproportionate amount of the available capacity, which placed those entities engaged in legitimate bidding at a competitive disadvantage that resulted in harm to them, and by extension, their customers.

Upon receipt of these complaints, staff opened an investigation and conducted discovery to ascertain the facts and circumstances surrounding the March 2007 open season to determine whether the conduct alleged constituted a violation of Cheyenne's Tariff or any of the Commission's rules or regulations.

C. Scope of Staff's Investigation

Based on the posting of "winning bidders" on Cheyenne's EBB, staff's initial screen for determining who to investigate was by identifying those companies that bid through entities with a common name or otherwise known to staff to be affiliated. As

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[8] All 48 bidders submitted bids at the highest possible NPV, however one bidder conditioned acceptance of its *pro rata* allocation on receiving a minimum volume of 2,500 Dth/d, and therefore was not awarded any capacity.

more facts were discovered, staff investigated other entities that were affiliated or had close business relations but whose relationships were not readily apparent.

Staff's investigation revealed the following about the 47 "winning" bids: five different groups of affiliated or closely-related entities accounted for 27 of the winning bids and obtained 57 percent of the capacity. Put another way, these five companies (and their affiliates) represented 20 percent of the pool of bidders but, by way of multiple-affiliate bidding, secured for themselves over 50 percent of the capacity awarded. Among that group of five was NFM, which, together with its affiliates, submitted four bids.

Importantly, staff's investigation also revealed that multiple-affiliate bidding was not always employed to defeat the *pro rata* allocation mechanism. In two separate cases, the facts established that multiple-affiliate bidding was employed to further the legitimate business interests of each affiliate bidder. In the first case, a large national energy company bid for the capacity through two affiliates, a marketing arm serving wholesale customers, and a retail operation securing capacity to serve its retail customers. The facts showed that the two entities, although affiliated, were bidding for capacity on Cheyenne that was intended to further their respective businesses. In the second case, a natural gas exploration and production company with assets in Wyoming bid for capacity on Cheyenne to deliver its gas to markets in the Midwest while its affiliated marketing arm bid to serve its wholesale customers. As to these two companies, staff concluded there was no improper conduct in violation of 18 C.F.R. § 1c.1. In both cases, the bids of the affiliates were independent and soundly based on satisfying the legitimate needs of the bidders.

As to the other companies: Tenaska, ONEOK, Seminole, NFM, Klabzuba, Jetco, Wizco, and Golden Stone, staff concluded their conduct in bidding for capacity on Cheyenne violated 18 C.F.R. § 1c.1. Staff was able to resolve its investigation of Tenaska, ONEOK, Klabzuba, Jetco, Wizco, and Golden Stone through settlement. With regard to Seminole and NFM, staff recommends the Commission order both to show cause why they did not violate 18 C.F.R. § 1c.1 in connection with their multiple-affiliate bidding on Cheyenne.[9]

III. National Fuel Marketing Company, LLC and its affiliates

NFM is a privately-held natural gas marketing company headquartered in Denver, Colorado. NFM purchases physical natural gas in the Rockies from small and medium-

[9] Seminole is the subject of another staff report being issued concurrent with this report.

sized producers and gas plants and then sells the gas to utilities, municipalities, local distribution companies, independent power producers, manufacturers and other end-users throughout the West and Mid-Continent regions.[10]

As NFM expanded from four employees in 2000 to its 22 employees as of October 2007, NFM planned to launch subsidiary companies and use its business model to "focus on certain specific midstream transaction [sic] in or maybe just outside of Texas, with the intention of growing the overall portfolio of business around the midstream asset to include major intrastate or interstate transportation deals, and major storage deals . . . ."[11] These direct and indirect subsidiaries are: NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering.

A. NFM Midstream

NFM Midstream, a subsidiary of NFM, was formed in 2005.[12] According to NFM, the business purpose of NFM Midstream is to, *inter alia*, "own and otherwise serve as a holding company for entities engaged in the business of owning, operating, and managing natural gas gathering systems, i.e. midstream assets, in various geographic areas."[13] According to Brenda Mayland, NFM's Chief Financial Officer (CFO) and Treasurer, prior to March 2007 NFM Midstream had no direct customers, no employees, and had not held capacity rights on Cheyenne.[14]

B. NFM Texas Pipeline

NFM Texas Pipeline, a subsidiary of NFM Midstream, was formed in 2005.[15] According to NFM, NFM Texas Pipeline "was set up with essentially the same purpose and intent of NFM Midstream, LLC . . . we were specifically interested in setting up companies with the name Texas in it to be more of a recognizable 'Brand' name for

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[10] NFM Data Response (Oct. 23, 2007) at p. 1.

[11] *Id*. at 3.

[12] NFM Data Response (Oct. 23, 2007) at p. 4.

[13] *Id*.

[14] August 21, 2007 deposition of Brenda K. Mayland (Mayland) at 14:20, 17:6, 34:15.

[15] NFM Data Response (Oct. 23, 2007) at p. 7.

developing and doing business in the state of Texas over the course of time."[16] In addition, NFM "desired that this company [NFM Texas Pipeline] be registered as a 'utility status' company in the state of Texas. By doing this, we would then have the legal status required in that state to legally condemn property for right of way purposes."[17] NFM states that the business purpose or "idea" of NFM Texas Pipeline "was to focus on certain specific midstream transactions in or maybe just outside of Texas, with the intention of growing the overall portfolio of business around the midstream asset to include major intrastate or interstate transportation deals, and major storage deals, to effectively organically 'grow' the subsidiaries. Employees were to be added as required to facilitate company management and growth independent of NFM the parent."[18] According to Mayland, prior to March 2007, NFM Texas Pipeline had no direct customers, no employees, and had not held capacity rights on Cheyenne.[19]

C. NFM Texas Gathering

NFM Texas Gathering, a subsidiary of NFM Midstream, was formed in 2006. Like NFM Texas Pipeline, NFM Texas Gathering "was set up with essentially the same purpose and intent of NFM Midstream, LLC . . . we were specifically interested in setting up companies with the name Texas in it to be more of a recognizable 'Brand' name for developing and doing business in the state of Texas over the course of time."[20] NFM further stated that the "business purpose of NFM Texas Gathering, LLC is to acquire, own, operate and manage natural gas gathering systems, i.e. midstream assets, in various geographic areas."[21] More specifically, NFM Texas Gathering was "to focus on certain specific midstream transactions in or maybe just outside of Texas."[22] According to Mayland, prior to March 2007, NFM Texas Gathering had fewer than ten direct customers, no employees, and had not held capacity rights on Cheyenne.[23]

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[16] *Id.*

[17] *Id.* at p. 5.

[18] *Id.*

[19] Mayland at 14:25, 17:18, 34:15.

[20] NFM Data Response (Oct. 23, 2007) at p. 5.

[21] *Id.*

[22] *Id.* at 8.

[23] Mayland at 14:22, 17:12, 34:15.

IV. Applicable Law

Upon receipt of the Hotline complaints, staff investigated whether the multiple-affiliate bidding of the NFM entities was in compliance with Cheyenne's FERC Gas Tariff and the Commission's rules and regulations. As the Cheyenne Tariff is silent on multiple-affiliate bidding, staff concluded that NFM did not violate Cheyenne's Tariff and focused on whether NFM's conduct violated 18 C.F.R. § 1c.1. Staff also investigated whether the NFM entities transported in compliance with the Commission's "shipper-must-have-title" requirement.

A. 18 C.F.R. § 1c.1

As announced by the Commission in Order No. 670, 18 C.F.R. § 1c.1 prohibits an entity from: (1) using a fraudulent device, scheme or artifice, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity; (2) with the requisite scienter; (3) in connection with the purchase or sale of natural gas subject to the jurisdiction of the Commission.[24] Order No. 670 defined fraud generally, that is, "to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market. Fraud is a question of fact that is to be determined by all the circumstances of a case."[25]

B. Shipper-Must-Have-Title Requirement

In order to promote pipeline open-access and to prevent undue discrimination in the primary and secondary markets for capacity, the Commission adopted a number of specific capacity release policies. Among them was the shipper-must-have-title requirement, under which a shipper must hold title to the gas being transported on the shipper's pipeline capacity.[26] This requirement is reflected in Original Sheet No. 251 of the General Terms and Conditions section of Cheyenne's FERC Gas Tariff.[27]

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[24] Order No. 670 at P 48.

[25] *Id*. at P 50.

[26] *Rendezvous Gas Services LLC*, 113 FERC ¶ 61,169, at P 40 (2005); *Enron Energy Services, Inc.*, 84 FERC ¶ 61,222, at 60,063 (1998); *Consolidated Gas Transmission Corp.*, 38 FERC ¶ 61,150, at 61,408 (1987) (*citing Texas Eastern Transmission Corp.*, 37 FERC ¶ 61,260, at 61,683-85 (1986)).

[27] Although the specific language of pipeline tariffs vary, the Commission has made clear that the shipper of record and the owner of the gas must be one and the same

(continued)

V. Staff's Findings of Fact and Conclusions of Law

A. Findings of Fact

NFM used its affiliates NFM Midstream, NFM Texas Gathering, and NFM Texas Pipeline to submit bids along with NFM to secure a larger allocation of scarce and valuable UAC 3 open season capacity than NFM could acquire through its single bid. NFM Midstream, NFM Texas Gathering, and NFM Texas Pipeline did not have any use for the transportation capacity for their respective businesses. Instead, NFM used the capacity awarded to these three affiliates to transport gas owned by NFM.

1. NFM's Motive in Cheyenne

On March 7, 2007, Edward "Buddy" Farah, NFM's Director of Natural Gas Marketing, received an e-mail from Steve Saye, formerly a Cheyenne marketing representative, alerting him and others to the March 2007 Cheyenne open season.[28] Shortly after receiving the e-mail, Farah forwarded it to two subordinates, Gary Sanchez, Manager of Transportation & Storage Services for NFM, and Jonathan (Jack) Krape, Natural Gas Marketer for NFM.[29]

Farah then instructed Krape to evaluate the economics of the available Cheyenne capacity.[30] Krape's analysis showed a favorable spread between the price of gas at the upstream Cheyenne receipt points and the market price for gas delivered at the downstream terminus of the pipeline. This favorable basis differential exceeded the total costs of the applicable transportation (*i.e.*, reservation rate, commodity rate, fuel, and lost and unaccounted for gas) by a significant margin. Accordingly, NFM knew that the

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throughout the course of the transportation or the duration of storage. *Enron Energy Services, Inc.*, 85 FERC ¶ 61,221, at 61,906 (1998).

[28] E-mail from Steve Saye, Marketing Representative, Cheyenne, to Edward Farah, Director of Natural Gas Marketing, National Fuel Marketing (Mar. 7, 2007 7:51am). Steve Saye is no longer in the employ of Cheyenne or any other El Paso Corporation entity.

[29] E-mail from Edward Farah, Director of Natural Gas Marketing, National Fuel Marketing, to Gary Sanchez, Manager of Transportation & Storage Services for National Fuel Marketing, and Jack Krape, Natural Gas Marketer for National Fuel Marketing (Mar. 7, 2007 8:11am).

[30] August 21, 2007 deposition of Jonathon B. Krape (Krape) at 18:21.

capacity was valuable.

2. NFM employed its affiliates to submit multiple bids

NFM is the corporate parent of NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering. In his deposition, Krape explained that NFM is the enterprises' primary acquirer and holder of pipeline capacity.[31]

The following Instant Message (IM) exchange between Krape and a trader at an unaffiliated energy marketing firm (that bid one entity in the Cheyenne open season) occurred on March 15, 2007. In the IM, Krape not only discusses NFM's intent in bidding multiple subsidiaries but, as highlighted by staff, expresses his knowledge of *Trailblazer* and FERC's concerns associated with multiple-affiliate bidding.

TRADER X: hey
JackKrape: hello there

* * *

[irrelevant portion of the IM exchange omitted]

JackKrape: were you able to get a piece of the chey plains capacity yesterday?
TRADER X: yes a little
JackKrape: good
TRADER X: but the BP's and BP subsidiaries of the world got it[32]
JackKrape: yeah, I was one of those as well
TRADER X: whatcha mean
JackKrape: gotta have the subs
JackKrape: lololol
JackKrape: it was small, but paid off pretty good, huh?
JackKrape: usually Tenaska is the one with all the subsidiaries
JackKrape: they kind of invented that approach about 5 years ago on trailblazer
JackKrape: and I have no idea where they hell they came up with some of these companies
TRADER X: interesting
JackKrape: Detroit Water company was 1 of them

[31] Krape at 25:23.

[32] In fact, only one BP entity, BP Energy Company, bid in the Cheyenne open season. BP is not a subject of this investigation.

JackKrape: lololol
TRADER X: omigosh
JackKrape: guess it was an intity though
TRADER X: wow
TRADER X: i hear some people were very upset
JackKrape: where they got ridiculed was after they were awarded the capacity, the pipe let them go and blend all the pieces into 1 contract… that was a no no I guess, and that won;t happen again
TRADER X: i mean I guess it has been done before (aka Trailblazer) but has it ever been to that degree
JackKrape: yeah, well Tenaska had 72 enities in that auction
JackKrape: it was like 50,000/d and got split like 95 ways
TRADER X: was that for Cheyenne plains stuff?
JackKrape: no, that was TB
JackKrape: chey plains was like 47 companies total
TRADER X: wow-
TRADER X: so trailblazer lumped it all under one company?
JackKrape: yes…
JackKrape: **and ferc will not allow that anymore** [emphasis supplied by staff]
JackKrape: so basically BP will have to no 30 different contracts on chey plains
JackKrape: if they got 30 different packages
JackKrape: havfe fun with that!
TRADER X: goodness
JackKrape: nothing wrong with what they did until they make a change in the Tariff….but they can't combine contracts
JackKrape: so that's gonna suck for them
TRADER X: yes—but it is worth it for them financially
TRADER X: but I gotta tell u
JackKrape: yeah, it is
TRADER X: i[t] almost feels a little too much like CAISO/Enron stuff
TRADER X: granted—on a smaller scale
TRADER X: for sure, but still has to make you wonder if someone isn't going to try and make a case for it
JackKrape: yeah, i totally agree… i mean people can try and fight it, we've tried in the past. nothing anyone can do, trust me on that
JackKrape: we're just lucky they didn't use all 15,000 legal entities that BP has
JackKrape: cause they seriously could have
JackKrape: and gotten away with it…. they might make a change in the future to limit this from happening, but nothing is going to stop them from getting this transport
TRADER X: i know
JackKrape: yeah….

TRADER X: and not justifying it but it would be hard to prove that they did this specifically to gain a larger share of the capacity
TRADER X: granted they did get more than any single counterparty, but they can always refer back to the Tariff where it says one credit worthy company can bid only one time for the capacity
JackKrape: yep, thats exactly right
TRADER X: so anyway—just par for the industry
JackKrape: yeah, i know… seriously give someone an inch they'll take a mile
TRADER X: if people are compensated for their financial performance they will find a way to make it work (even within the guidelines)
JackKrape: yeah, that is true[33]

Krape is the NFM employee who placed the bids for each of the four NFM affiliates that bid in the Cheyenne open season. Krape testified that he placed these bids with the express approval of Dan Joss, who is President and senior manager of all four NFM affiliated bidders.[34]

Anticipating that interest in this Cheyenne capacity would be high and that the capacity would ultimately be allocated on a *pro rata* basis among bidders,[35] Farah instructed Krape to call the pipeline to determine whether Cheyenne would accept bids from multiple affiliates.[36] Krape called his representative at Cheyenne, and asked if Cheyenne was accepting bids from multiple affiliates. Krape testified that the representative "responded there's nothing in our Tariff that limits you from doing that." Krape also testified that he asked the representative if he was the first person to ask that question and the response was "no."[37] Krape did not disclose that the purpose of the bids of NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering was to secure additional capacity for NFM.

3. NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering were bid for the benefit of their corporate parent, NFM

In his deposition, Krape explained that the capacity awarded in the Cheyenne open

[33] Krape at Exhibit 1 (typographical errors in original).

[34] Krape at 30:2.

[35] *Id*. at 22:12-15.

[36] *Id*. at 21:7-10.

[37] *Id*. at 21:14-24.

season was used to serve NFM's customers.[38] In the words of Krape, NFM's interest in submitting several bids through multiple affiliates was: "to get as much capacity as we could."[39] This was echoed by the following excerpt from the deposition transcript of Mayland, NFM's CFO and Treasurer:

> Q: Is the purpose of that [*i.e.*, the submission of bids by NFM and its three affiliates] to acquire more capacity for the company than National Fuel Marketing Company could acquire by itself if it were to bid alone?
>
> A: That's the way it worked, yeah, and to provide more reliability to our customers.[40]

The additional reliability Mayland spoke of inured only to the benefit of NFM's customers because, according to Mayland, NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering did not use the capacity acquired to serve any of their own customers.[41] The deposition testimony of Mayland establishes that NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering submitted bids to secure more capacity for NFM, not to further the business objectives of NFM Midstream, NFM Texas Pipeline, or NFM Texas Gathering.[42]

4. The Capacity Acquired by NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering Was Used to Further the Business Interests of NFM

On March 14, 2007, after learning the capacity that was awarded to the four NFM bidders, Krape set to work on engaging in transactions that would enable NFM to realize profits from the capacity awarded to NFM Midstream, NFM Texas Gathering, and NFM Texas Pipeline. In a spreadsheet (shown below), which Krape sent Joss, the economics of the Cheyenne transactions are calculated on an aggregate basis as shown by the "Volume" numbers in the spreadsheet (in the box staff drew on the spreadsheet below, the 1,489 Dth/d of April capacity awarded to each affiliate is aggregated for a total of

[38] *Id*. at 43:15.

[39] *Id*. at 28:7-9.

[40] Mayland at 27:4-8.

[41] *Id*. at 37:22-24; 38:8-11, 12-21. Staff's position is not that an entity must have a customer in place before bidding for open season capacity.

[42] *Id*.

5,956 Dth/d).[43]

Chey Plains.xls

	Volume	CIG Basis	NGPL	Chey Hub Premium	Cheyenne Plains Demand	Chub Basis	Spread			
April	5,956	1.88	0.89	0.21	$61,412.00	1.65	0.76	4526.56	$135,796.80	$74,384.80
May	3,828	1.916	0.86	0.21	$39,472.00	1.706	0.855	3272.94	$101,461.14	$61,989.14
Sept	3,828	2.67	0.835	0.21	$39,472.00	2.46	1.625	6220.5	$186,815.00	$147,143.00
Oct	5,956	2.775	0.94	0.21	$61,412.00	2.566	1.825	9678.5	$300,033.50	$238,621.50
					$201,768.00				$723,906.44	$522,138.44

The fact that it was NFM's intent to use the capacity acquired by its affiliates to benefit itself is established by an e-mail between NFM's president, Joss, and NFM's CFO, Mayland. The significance of the e-mail below is not the fact that NFM provided a credit guarantee for its affiliated subsidiaries, but rather the fact that NFM's intent was always to pay for the transport for all the entities because at all times their purpose was to obtain NFM more transportation capacity.

From: Dan Joss
Sent: Thursday, March 15, 2007 3:28 PM
To: Brenda Mayland
Subject: RE: Guaranty

Fine by me

From: Brenda Mayland
Sent: Thursday, March 15, 2007 5:27 PM
To: Dan Joss
Subject: Guaranty

Since you seem to be answering emails and not i-ms......

Do you have a problem with National Fuel Marketing signing a guaranty for Cheyenne Plains guaranteeing payments from NFM Midstream, NFM Texas Gathering and NFM Texas Pipeline?

I do not have an issue since National Fuel Marketing is going to pay for the tport anyway.....

5. NFM held title to gas transported by its affiliates

NFM did not transport gas it produced or otherwise owned prior to March 2007 on

[43] E-mail from Krape to Dan Joss, President of NFM, and Edward "Buddy" Farah, Director of Natural Gas Marketing, NFM (Mar. 14, 2007 6:47pm).

the capacity it acquired in the March 2007 open season.[44] Instead, as demonstrated by NFM's transactions for the April 2007 Cheyenne capacity, NFM (*not* its affiliates) bought 7,500 MMBtu/d of gas from Western Gas Resources at the Cheyenne Hub and NFM (*not* its affiliates) sold 5,956 MMBtu/d of gas to BP Energy at the NGPL Midcon pool. In the Cheyenne open season, for April 2007, NFM acquired only 1,489 Dth/d of capacity, however, with the additional capacity acquired by NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering, NFM had 5,956 MMBtu/d of capacity enabling it to sell BP 5,956 MMBtu/d of gas at the NGPL Midcon pool.[45] Therefore, as the transportation and purchase and sale documentation confirms, NFM was able to sell because it used the capacity acquired by its three affiliates. The facts also establish that NFM held title to the gas transported by its affiliates.[46]

B. Conclusions of Law

1. 18 C.F.R. § 1c.1

A violation of 18 C.F.R. § 1c.1, requires three elements: (1) using or employing a fraudulent device, scheme or artifice, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity, (2) with scienter, and (3) in connection with a transaction subject to the jurisdiction of the Commission.

a. Fraudulent device, scheme or artifice; or engage in any act, practice, or course of business that operates or would operate as a fraud

As to the first element under 18 C.F.R. § 1c.1, the facts support a finding that NFM used a device, scheme or artifice to defraud, or that NFM engaged in an act, practice, or course of business that operated or would operate as a fraud or deceit upon legitimate bidders for Cheyenne open season capacity. Staff views the submission of multiple bids by the NFM entities for the sole purpose of acquiring a larger share of the *pro rated* Cheyenne capacity for NFM as such a scheme or artifice. The only explanation offered by NFM for the bids of its affiliates, that each wanted to build their brand, is a post-hoc rationale that finds no support in either the documents generated by NFM employees at the time of the Cheyenne open season or in the deposition testimony

[44] Data Response No. 2 (May 23, 2008).

[45] Data Response Nos. 3, 4, and Appendix A (May 23, 2008).

[46] *Id*.

of NFM's CFO and Treasurer, Mayland, and NFM's trader, Krape. The documents and testimony establish NFM affiliates' bids had no discernable purpose other than to gain an uncompetitive advantage in the open season by defeating the *pro rata* allocation mechanism.

Multiple-affiliate bidding was NFM's means to commit fraud here. There is no question NFM engaged in multiple-affiliate bidding. There is also no question the purpose of the multiple-affiliate bidding was to benefit NFM.

NFM contends that it did not violate 18 C.F.R. § 1c.1 because it had no duty to disclose to the other open season bidders its plan to employ multiple-affiliates as it did. As such, NFM argues that because it said nothing, it cannot be deemed to have been deceptive within the meaning of 18 C.F.R. §1c.1.

Staff does not dispute that NFM owed no duty of disclosure to the other Cheyenne open season bidders. However, the absence of a duty to disclose does not eliminate the deceptiveness of its conduct within the meaning of 18 C.F.R. § 1c.1. NFM's argument that 18 C.F.R. § 1c.1 requires an affirmative misrepresentation is false, and ignores statements of the Commission in Order No. 670 to the contrary.[47]

In Order No. 670, when discussing the limits of the applicability of Securities and Exchange Commission (SEC) Rule 10b-5 precedent, the Commission recognized that the SEC does not have a duty to assure that the price of a security is just and reasonable, and that Commission's duty is not to protect purchasers through a regime of disclosure.[48] With regard to securities law precedent on such issues as disclosure, the Commission stated that it "intends to recognize, on a case-by-case basis, that the roles of the Commission and the SEC are not identical in determining whether it is appropriate to adopt securities precedents to specific energy industry facts, circumstances, or situations."[49] Despite these differences in mission, the Commission recognized that wholesale natural gas markets, like securities markets, are susceptible to fraud and market manipulation.[50]

NFM's conclusion that a misrepresentation is required under 18 C.F.R. § 1c.1 is erroneous. In support of its argument, NFM inexplicably cites a footnote to the

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[47] *See, e.g.*, Order No. 670 at P 36.

[48] *Id*. at P 32.

[49] *Id*. at P 31.

[50] *Id*. at P 32.

paragraph of Order No. 670 where the Commission requires a showing of scienter. Notwithstanding the plain and unrelated meaning of the text, NFM believes this footnote stands for the proposition that a misrepresentation is a *sine qua non* of 18 C.F.R. §1c1.[51] The footnote merely describes the holding of a securities case as it relates to the issue of scienter.[52] NFM compounds its misreading of Order No. 670 by incorrectly arguing SEC Rule 10b-5 requires a misrepresentation. Like 18 C.F.R. § 1c.1, SEC Rule 10b-5 has no such requirement. Instead, courts have been clear that fraud and manipulation under SEC Rule 10b-5 can be found in the conduct of a market participant. For example, in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 769 (2008), the Supreme Court was unambiguous in stating that if a litigant or lower court were to "suggest there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5, it would be erroneous. Conduct itself can be deceptive . . . ." In *SEC v. U.S. Envtl., Inc.*, 82 F. Supp. 2d 237, 240 (S.D.N.Y. 2000), the court noted that SEC Rule 10b-5 cases "do not necessarily involve affirmative misrepresentations."

In a related argument, NFM claims that it did not deceive anyone because it did not give any party a false impression. The facts, of course, are that NFM's bids were submitted in secret. Necessarily then, NFM's fraud was perfected under the cover of a closed bidding process. It was not until Cheyenne posted the results of the open season on its EBB that NFM's fraud became visible to those it harmed.

In *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971), the Supreme Court cited and quoted with approval the Second Circuit's holding in *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) ("We believe that § 10 (b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws")(emphasis in original). Whether novel or garden-variety, NFM's conduct on Cheyenne was intended to, and did in fact, alter the outcome of the open season to its benefit and to the detriment of other bidders.[53]

[51] Order No. 670 at P 52.

[52] *Id*. at fn. 107.

[53] *See Markowski v. SEC*, 274 F.3d 525, 528 (D.C. Cir. 2001), *cert. denied*, 154 L. Ed. 2d 26, 123 S. Ct. 96 (2003) (noting deceptive conduct intended to affect the result of market activity is fraud).

i. NFM's Conduct is Analogous to Bid-Rigging

NFM's multiple-affiliate bidding can be analogized to another species of conduct affecting the outcomes of auctions and long held to be fraudulent, bid rigging. *See, e.g.*, *McMullen v. Hoffman*, 174 U.S. 639 (1839); *Bonilla v. Volvo Car Corp.*, 150 F.3d 62, 72 (1st Cir. 1998) (providing bid-rigging as an example of a class of cases involving "a sufficient measure of deception to qualify as fraud"); *New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1083-84 (2d Cir. 1988) (describing bid-rigging as a "self-concealing fraud[]"). There are many variations of bid-rigging, but all involve the elimination of competition. *See, e.g., Harkins Amusement Enterprises, Inc. v. General Cinema Corp.*, 850 F.2d 477, 487 (9th Cir. 1988) (noting that conduct designed to "eliminate competitive bidding" comes under the heading of "bid-rigging"). NFM's multiple-affiliate bidding was necessarily designed to lessen competition because the pool of available capacity was finite and the price capped by Cheyenne's Tariff. Therefore, if the only variable is allocation, and one bids multiple affiliates to obtain more capacity for a single affiliate because one knows the capacity will be allocated *pro rata*, then by definition competition is lessened because the additional bidders will necessarily receive less capacity – not because they valued it any less, but because they did not bid affiliates that had no legitimate use for the capacity.

NFM objects to staff analogizing its conduct to bid-rigging as "inflammatory." In its defense, it relies on the Supreme Court's opinion in *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984). In that case, the Supreme Court reversed a Seventh Circuit decision finding that Copperweld had conspired with its wholly owned subsidiary, Regal, in violation of section 1 of the Sherman Act. *See Independence Tube Corp. v. Copperweld Corp.*, 691 F.2d 310 (7th Cir. 1982), *rev'd*, 104 S. Ct. 2731 (1984). The trial court had found that Copperweld and Regal conspired to restrain trade in the structural steel tubing market by warning several prospective suppliers and customers against dealing with Independence Tube, a potential competitor. *See Copperweld*, 104 S. Ct. at 2735. In addition to warning suppliers and customers not to deal with Independence, Copperweld and Regal warned banks and real estate firms. As a result of these efforts, Yoder, a steel tubing mill company, reneged on its agreement to provide Independence with a steel tubing mill. As can be seen, the facts of *Copperweld* have nothing in common with the facts of NFM's bidding in Cheyenne. Staff does not take issue with the fact that *Copperweld* stands for the proposition that because a parent ultimately controls its wholly owned subsidiary, the two share a "unity of interest." *Id*. at 2742. The holding in *Copperweld*, however, is irrelevant in this matter because staff is not seeking to shoehorn NFM's conduct into an antitrust violation. Rather, staff uses the antitrust cases to support staff's contention that bidding designed to

harm competition is, and has long been deemed, fraud.[54]

NFM's *Copperweld* "defense" is misplaced because, taken to its logical extension, the Commission would be powerless to deem NFM's use of 100 or even 1,000 affiliates as a device or contrivance to defraud under 18 C.F.R. § 1c because of the Supreme Court's limited holding in *Copperweld* that a parent and affiliate cannot conspire with each other.

For the purpose of examining NFM's corporate form and related conduct, the relevant law is not *Copperweld* but *Transco*, which was decided in the wake of *Copperweld* and is specific to the NGA.

In *Transco*, the court upheld a Commission order that found Transco had used subsidiary affiliates to engage in a complicated scheme to do that which Transco could not do absent the use of subsidiaries. The *Transco* court stated that the "ALJ and the Commission correctly looked behind corporate forms and found that the three companies really were one. For the Commission not to have investigated further would frustrate a statutory purpose by allowing Transco to set up subsidiaries to sell gas at prices at which the company could not legally sell."[55] Similarly, in *Capital Tel. Co. v. FCC*, 498 F.2d 734, 738, n.10 (D.C. Cir. 1974), the D.C. Circuit held: "[w]here the statutory purpose could be easily frustrated through the use of separate corporate entities a regulatory commission is entitled to look through the corporate entities and treat the separate entities as one for purposes of regulation."

Staff is doing as the Fifth Circuit instructed in *Transco*: looking through NFM's corporate form to determine, consistent with all prior Commission statements on the issue

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[54] Although the Commission is not bound by the dictates of the antitrust laws, it is obliged to weigh antitrust policy in its NGA deliberations. *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 958-60 (D.C. Cir. 1968). For over a century, an agreement to rig bids has been regarded as illegal *per se*, *i.e.*, "noncompetitive," under the antitrust laws, specifically the Sherman Act. *See, e.g.*, *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, 278-279 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). Indeed, bid-rigging is one of the "archetypal" anticompetitive agreements found illegal *per se* under the Sherman Act. *See, e.g.*, *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647 (1980); *Northern Pacific Railway v. United States*, 356 U.S. l, 5 (1958); *United States v. Brighton Building & Maintenance Co.*, 598 F.2d 1101, 1106 (7th Cir. 1979), *cert. denied*, 444 U.S. 840 (1979).

[55] *Transcontinental Gas Pipe Line Corp. v. FERC*, 998 F.2d 1313, 1321 (5th Cir. 1993).

of multiple-affiliate bidding, whether NFM employed its affiliates to do what it otherwise could not: increase its allocation of capacity.[56] In so doing, NFM used its corporate form to frustrate two purposes of the NGA. First, the purpose of the NGA is to protect consumers.[57] Pursuant to that mandate, the Commission has promulgated rules and regulations designed to foster an open, competitive natural gas market by *inter alia* ensuring that capacity goes to those who value it most (not to those who bid the most subsidiaries).[58] The bids of NFM's affiliates and the transportation of gas owned by NFM using the capacity held by its affiliates, shielded from public view the real nature of the affiliate bids and, in the process, violated the "shipper-must-have-title" requirement which is intended to further the Commission's open access program regulations under the NGA.[59] Second, as amended by the EPAct 2005, the NGA's purpose is also to foster well-functioning markets free of market manipulation and fraud.[60] By employing its subsidiaries as it did, NFM made it impossible for those who valued it equally to share it equally by way of *pro rata* allocation. In this case, NFM's bidding was not soundly based on satisfying the legitimate needs of NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering. Rather, NFM used its affiliate subsidiaries to grant itself an unfair competitive advantage.

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[56] As discussed *infra*, in Order No. 2005, the Commission stated a general principle that bids of multiple-affiliates are examined to determine whether they are "soundly based on satisfying the legitimate needs of the bidder, or whether they are made to 'game' the open season." Order No. 2005 at P 99.

[57] 15 U.S.C. 717 *et seq.*; *see generally FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612, 64 S. Ct. 281, 292, 88 L. Ed. 333 (1944) (NGA is "plainly designed to protect the consumer interests against exploitation . . .").

[58] *See, e.g.*, *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, FERC Stats. & Regs. Regulations Preambles (July 1996–December 2000) ¶ 31,091 at 31,300 (2000) (Order No. 637); *order on rehearing*, Order No. 637–A, FERC Stats. & Regs, Regulations Preambles (July 1996– December 2000) ¶ 31,099 at 31,648 (2000) (Order No. 637–A); and Order No. 637–B, 92 FERC ¶ 61,062 (2000) (Order No. 637–B), *aff'd in part and remanded in part*, *Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18 (DC Cir. Apr. 5, 2002), *Order on Remand*, 101 FERC ¶ 61,127 (2002).

[59] *Id*.

[60] 15 U.S.C. 717c-1 (2008).

ii. Artificial Price Is Not An Element of 18 C.F.R. §1c.1 Violation

NFM argues that it did not violate 18 C.F.R. § 1c.1 because it did not create an artificial price. Staff does not, and need not, argue that NFM created an artificial price. Rather, NFM was conducting closed-market transactions to affect allocation. Any argument that 18 C.F.R. § 1c.1 prohibits only manipulation of market prices ignores the unique nature of the industry and markets subject to the Commission's jurisdiction. To argue that Congress' broad grant of anti-fraud authority to the Commission is inapplicable to any instance in which there is a Commission-approved Tariff on file for a regulated service is without merit.[61] This is so because the logical extension of the argument would be that so long as misconduct can be tied to a tariff, even where, as here, staff is not alleging a tariff violation, then all other Commission regulations, including 18 C.F.R. § 1c.1, do not apply. Even under SEC Rule 10b-5, which is often applied to manipulation of market prices, courts have expressly stated that deceptive conduct intended to affect the result of market activity is unlawful. *See Markowski*, 274 F.3d at 528.

iii. Commission History With Multiple-Affiliate Bidding Cannot Be Read to Condone NFM's Fraud

Staff is not, as NFM argues, changing the rules regarding multiple-affiliate bidding. Instead, the opposite is true. Staff's use of 18 C.F.R. § 1c.1 to ferret out multiple-affiliate bidding employed to further a fraud is consistent with prior Commission statements and warnings on the issue, especially the Commission's statements in Order No. 2005 mentioned above and discussed further below.

1. *Pacific Gas Transmission*

The Commission first dealt with the issue of multiple-affiliate bidding in the 1991 *Pacific Gas Transmission Co. (PGT)* rate-making proceeding.[62] Here is the entirety of what the Commission said on the subject of multiple-affiliate bidding in its 88-page Order:

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[61] It is a well-settled principle that "interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available." *Griffin v. Oceanic Contractors*, 458 U.S. 564, 575 (1982), *citing United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 542-43 (1940).

[62] *Pacific Gas Transmission Co.*, 56 FERC ¶ 61,192, 61,721 (1991).

> We will not require PGT to implement new open-season procedures. While we interpret the open-season procedures as prohibiting PGT from accepting multiple bids from one bidder, we do not read those procedures as prohibiting PGT from accepting separate bids from a parent shipper and its affiliates, as long as each affiliate (which is a separate entity under law) submits one bid.[63]

Contrary to NFM's assertion, there is no inconsistency between staff's conclusion that the NFM entities violated 18 C.F.R. § 1c.1 in connection with their multiple-affiliate bidding and the Commission's statements in *PGT*. Staff does not take issue with multiple-affiliate bidding by itself. To be clear, whether multiple-affiliate bidding is legitimate or operates as a fraud is a question of fact. Staff's views in this case are not an effort by staff to advance a change in policy as it relates to open season bidding. In fact, staff's investigation of the March 2007 Cheyenne open season provides two instances that demonstrate this point. As mentioned above, staff investigated two separate companies where we found no violation of 18 C.F.R. § 1c.1 in connection with their multiple-affiliate bidding. In the first, an enterprise bid two affiliates, one a wholesale marketing affiliate serving its wholesale customers and the other a retail service affiliate serving its retail customers. In the second, a natural gas producer bid to transport its gas to market and its marketing affiliate bid to serve its customers. In both cases, these entities bid to make use of the capacity for their businesses, not to enlarge the share of valuable capacity obtained.

In marked contrast, three NFM subsidiary affiliates were employed for no other reason than to secure NFM more capacity by defeating the pro rata allocation mechanism relied upon by Cheyenne and the other bidders to ensure a fair allocation of scarce and valuable capacity. The Commission's statements in *PGT* do not condone multiple-affiliate bidding employed to perpetrate a fraud. Further, *Transco* instructs the Commission to look behind the corporate forms when necessary to effectuate its statutory purpose. Accordingly, staff's case exists in harmony with *PGT*.

2. *Trailblazer*

Congress, by the passage of EPAct 2005, recognized the need for the Commission to have a rule whereby it could examine all of the transactions subject to its jurisdiction, on a case-by-case basis, and after considering all the facts and circumstances of each case, to determine whether those transactions constitute a fraud. Acting pursuant to the intent of Congress, the Commission promulgated 18 C.F.R. § 1c.1, which broadly

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[63] *Id*.

speaking prohibits fraud. The Commission lacked this authority in 2002 when the issue of multiple-affiliate bidding next arose.

In September and October of 2002, Trailblazer held three open seasons for interstate pipeline capacity. Trailblazer capacity then, like that of Cheyenne in 2007, was in high demand because it carried low cost gas originating in the Rockies region to higher priced markets in the mid-continent region.

In the first Trailblazer auction, 19 Tenaska companies submitted winning bids. Through Trailblazer's *pro rata* mechanism, the Tenaska companies collectively received 43 percent of the open season capacity. The Tenaska companies then released their capacity to a single Tenaska company. As with Cheyenne today, staff became aware of the bidding behavior of Tenaska on Trailblazer by way of calls to the Hotline from market participants. After being informed of this behavior, and learning that Trailblazer planned to conduct a second auction, staff requested that Trailblazer post on its EBB a notice to the effect that staff was monitoring capacity releases on Trailblazer. Notwithstanding the notice posted in advance of the second auction, Tenaska repeated its multiple-affiliate bidding when it submitted 23 of 68 "winning" bids in the second auction, and was collectively awarded 34 percent of the capacity. This time, however, the winning Tenaska affiliates did not release their capacity to a single Tenaska company. Rather, one Tenaska company served as an agent for the affiliates and managed the capacity. Trailblazer then conducted a third auction. In the third auction, Tenaska submitted 33 of the 92 bids and was awarded 36 percent of the capacity. Similarly, NFM submitted multiple-affiliate bids in the Trailblazer open seasons.

Then, like now, staff received calls to the Hotline from market participants. Staff investigated the bidding of Tenaska, NFM and others. As the conduct on Trailblazer pre-dated EPAct 2005, the Commission was without statutory authority in the NGA prohibiting fraud and, of course, it did not have 18 C.F.R. Part 1c in its regulations. Nevertheless, before closing its investigations, staff did take actions in an effort to discourage such multiple-affiliate bidding. Most prominent of these efforts was the posting staff asked Trailblazer to post on its EBB in which industry was warned that staff believed that bidders may be able, through the use of affiliated bidders, to "game" auctions of released capacity in which several bids have an equal Winning Bid Value, so that the capacity is awarded on a pro rata basis.

As part of a subsequent rate case, Trailblazer requested and received approval to change its tiebreaker mechanism from *pro rata* to first-in-time. Approving this tariff change, the Commission noted "that no single tiebreaker method is definitely better than

other methods," and that "each system has advantages and disadvantages."[64] The Commission was silent on whether multiple-affiliate bidding of the sort observed in Trailblazer was permissible, and it is a well-settled principle that the Commission speaks through its orders, not the absence thereof.[65]

3. *Order No. 2005*

NFM concedes in a footnote, as it must, that *Trailblazer* was not the last time the Commission or its staff addressed the issue of multiple-affiliate bidding prior to the passage of EPAct 2005. In Order No. 2005, the Commission stated that multiple-affiliate bidding in open seasons must be examined closely to determine whether the bids are soundly based on satisfying the legitimate needs of the bidder, or whether they are made to "game" the open season process. Order No. 2005 at P 99. Staff believes that NFM's conduct is the sort of "game" the Commission was referring to in Order No. 2005 because NFM and its subsidiary affiliates were acting as one to advance the interests of NFM.

iv. Multiple-Affiliate Bidding to Defeat Pro Rata Allocation Mechanisms is Not a Common Industry Practice

NFM's conduct was not a common industry practice. This is perhaps best demonstrated by the fact that the majority of bidders in the Cheyenne open season did not engage in multiple-affiliate bidding to gain an unfair advantage. Further, the misconduct of NFM and others in the March 2007 Cheyenne open season came to the attention of Enforcement by way of calls to the Hotline from other winning bidders. Even assuming *arguendo* that multiple-affiliate bidding to defeat *pro rata* allocation is a widely used practice, analogy to precedent under SEC Rule 10b-5 establishes that even wide-spread and long-standing industry practices can constitute fraud. For example, in *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266 (3d Cir. 1997), a unanimous

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[64] *Trailblazer Pipeline Co.*, 103 FERC ¶ 61,225, 61,869 (2003), *order on reh'g and compliance filing*, 108 FERC ¶ 61,049, 61,305 (2004).

[65] *See MidAmerican Energy Holdings Co.*, 118 FERC ¶ 61,003 at P19, n. 45 (2007) ("The Commission, a five-member agency, acts through its written orders, which are 'issued' following a favorable vote of the majority. Phrased differently, in the absence of such orders . . . the Commission cannot be said to have acted." (citations omitted)). *See also Entergy Services, Inc.*, 119 FERC ¶ 61,187 at P52, n.44 (2007); *Indianapolis Power & Light Co.*, 48 FERC ¶ 61,040 at 61,203, n.29 ("The Commission speaks through its orders"), *order on reh'g*, 49 FERC ¶ 61,328 (1989).

en banc Third Circuit found that the execution of stock trades at prices offered on the central National Best Bid and Offer (NBBO) by brokers who failed to investigate other feasible alternatives that potentially offered better prices to the NBBO, albeit the industry standard, could still be considered fraudulent behavior. *Id.* at 274 ("[e]ven a universal industry practice may still be fraudulent"); *accord Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1171-72 (2d Cir. 1970) (non-disclosure of widespread industry practice may still be non-disclosure of material fact); *Opper v. Hancock Securities Corp.*, 250 F. Supp. 668, 676 (S.D.N.Y. 1966) (industry custom may be found fraudulent, especially on first occasion it is litigated) *aff'd*, 367 F.2d 157 (2d Cir. 1966).

The *Newton* case involved a breach of fiduciary duty between broker and client; staff is not claiming NFM owed the other bidders a fiduciary duty. This distinction between the conduct in *Newton* and the conduct of NFM on Cheyenne does not diminish the importance of *Newton*'s instruction. This point is demonstrated by the *Newton* court's reference with approval to an SEC investigation of a long-standing industry practice that did not involve the breach of a fiduciary duty. *Newton,* 135 F.3d at 274-75 *citing* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, 1996 SEC LEXIS 2146 (Aug. 8, 1996). Therefore, the general proposition in *Newton* that a common industry practice can be fraud is a sound legal principal upon which the Commission can look to for guidance when administering 18 C.F.R. § 1c.1.

v. Order No. 670 Put All Entities on Notice that Transactions Must Be Viewed Through the Prism of 18 C.F.R. § 1c.1

Notwithstanding the fact that NFM was investigated for nearly identical conduct on Trailblazer in 2002, staff posted a warning on Trailblazer's EBB regarding multiple-affiliate bidding, Trailblazer changed the capacity allocation mechanism in its tariff, the Commission *specifically* warned of improper multiple-affiliate bidding in Order No. 2005, and NFM's own trader seemed to be aware of the potential for multiple-affiliate bidding to be employed as a fraud (e.g., that FERC would "not allow that anymore"), NFM still maintains that it is "shocked" that staff would conclude that its multiple-affiliate bidding on Cheyenne violates 18 C.F.R. § 1c.1.

NFM is of the view that the Commission must classify a specific species of conduct as fraud before it can apply 18 C.F.R. § 1c.1. NFM's arguments here ignore not only the Commission's and staff's pre-EPAct 2005 warnings regarding its conduct but also the purpose and effect of Order No. 670: fair notice, consistent with all due process, that transactions subject to the Commission's jurisdiction must be viewed through the prism of 18 C.F.R. § 1c.1.

In Order No. 670, the Commission codified the statutory prohibition of fraud and

manipulation in natural gas markets granted by Congress in EPAct 2005. Order No. 670 was issued in accordance with the Administrative Procedure Act, 5 U.S.C. § 553 *et seq*., which establishes the procedural requirements for notice-and-comment rulemaking. The Commission employed public notice-and-comment procedures and gave all interested persons an opportunity to participate in the making of 18 C.F.R. § 1c.1 through submission of written comments. *See generally Long Island Care at Home, Ltd. v. Coke*, 127 S. Ct. 2339, 2351 (2007) (noting that the "object" of notice-and-comment rulemaking under 5 U.S.C. § 553 "is one of fair notice"). Thirty parties filed comments and nine parties filed reply comments, all of which the Commission considered. Upon the issuance of Order No. 670, only one entity requested rehearing (related specifically to a statute of limitations issue), and no one appealed the order.[66]

In Order No. 670, the Commission said that 18 C.F.R. § 1c.1 "prohibits the use of employment of any device, scheme, or artifice to defraud. The Commission defines fraud generally, that is, to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market. Fraud is a question of fact to be determined by all the circumstances of a case."[67] The Commission also set forth the elements that comprise a violation of 18 C.F.R. § 1c.1 so as to reduce regulatory uncertainty and thereby assure greater compliance.[68]

Like SEC Rule 10b-5, the language of 18 C.F.R. § 1c.1 is broadly proscriptive. *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (stating that Securities Exchange Act of 1934 section 10(b) and SEC Rule 10b-5 should be "construed not technically and restrictively, but flexibly to effectuate its remedial purposes") (internal citations and quotations omitted). The Commission is not obligated to outline every potential situation or activity that could lead to a Commission enforcement action before that situation takes place. *U.S. v. Arcadipane*, 41 F.3d 1, 5 (1st Cir. 1994) ("Fair warning, however, does not mean that the first bite is free, nor does the doctrine demand an explicit personalized warning"). Not only is it unnecessary for the Commission to outline every fraudulent scheme that could ever be found to violate 18 C.F.R. § 1c.1, it would be impossible to do so. *See McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000) *citing Isaacs v. United States*, 301 F.2d 706, 713 (8th Cir. 1962) (stating, "we recognize that the forms of fraud are as multifarious as human ingenuity can devise; that courts consider it difficult, if not impossible, to formulate an exact, definite and all-inclusive definition thereof; and that

[66] *Prohibition of Energy Market Manipulation*, Order Denying Rehearing, 114 FERC ¶ 61,300 (Mar. 22, 2006).

[67] Order No. 670 at P 50.

[68] *Id*. at P 48.

each case must be determined on its own facts").

vi. NFM's Policy Arguments are Without Merit

In connection with its notice argument, NFM has argued to staff that applying 18 C.F.R. § 1c.1 in this case will cause undue regulatory uncertainty because open season bidders will not know what conduct is legitimate. It argues for a rulemaking where the Commission would draw lines, in the absence of specific facts, outlining the acceptable contours of multiple-affiliate bidding. NFM makes this argument with full knowledge that the Commission in *Trailblazer* and Order No. 2005 rejected similar requests. NFM's argument is also at odds with the fact that the overwhelming majority of bidders in the Cheyenne open season did not engage in the sort of conduct NFM did. As previously pointed out, staff investigated and found no wrongdoing by two companies that each bid multiple-affiliates. That is so because distinctions can and should be made under 18 C.F.R. § 1c.1 by applying facts to section 1c's elements to determine whether conduct is legitimate or fraudulent.

The bright-line approach to fraud advocated by NFM is also in direct conflict with the approach relied on by the Commission in a recent case arising under 18 C.F.R. Part 1c. In *DC Energy, LLC v. H.Q. Energy Services (U.S.), Inc.*, the Commission reiterated the view expressed in Order No. 670 that the determination of whether a transaction violates 18 C.F.R. Part 1c is necessarily a fact-specific, case-by-case inquiry.[69]

The Commission's rejection of bright-line tests in the area of fraud and market manipulation is supported by the Supreme Court's analysis of the same under SEC Rule 10b-5. *Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988) ("[a] bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the securities acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or under inclusive."); *accord United States v. Canova*, 412 F.3d 331, 354 (2d Cir. 2005) ("We are skeptical as to whether fraud lends itself to the bright line drawing urged by [defendant] . . .").

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[69] *DC Energy, LLC v. H.Q. Energy Services (U.S.), Inc.*, 124 FERC ¶ 61,295 (2008), Enforcement Staff Report p. 9 (". . . each case will rely on a determination of all the circumstances concerning the entity's conduct. There are no per se violations of Part 1c. Rather, all facts surrounding the conduct must be examined and all of Part 1c's elements must be satisfied").

b. Scienter

NFM violated 18 C.F.R. § 1c.1 by employing multiple affiliates with the intent to defeat the *pro rata* allocation mechanism relied upon by Cheyenne to ensure fair and non-discriminatory allocation of the open season capacity.

The facts above, particularly staff's depositions of Krape and Mayland, provide clear evidence of NFM's intent to bid NFM Midstream, NFM Texas Gas Pipeline, and NFM Texas Gathering for the purpose of securing NFM more capacity to the detriment of the other open season bidders. As Krape said under oath, the capacity awarded in the Cheyenne open season was used to serve only NFM's customers.[70]

Still more evidence of NFM's intent is demonstrated by the above-transcribed IM exchange between Krape and Trader X. This exchange is more than mere boastful trader talk; it is clear evidence of NFM's intent to use multiple-affiliates to defeat the *pro rata* allocation mechanism employed by Cheyenne so as to secure more capacity for NFM. For example, Krape tells Trader X, "gotta have the subs . . . lololol . . . it was small, but paid off pretty good, huh?"[71] The fact that in the IM exchange Krape expresses his belief that nothing in Cheyenne's Tariff prohibits multiple-affiliate bidding does nothing to vitiate the intent of NFM to use its "subs" to defeat the *pro rata* allocation mechanism employed by Cheyenne.

As noted earlier, the fact that Krape called the pipeline does nothing to eliminate NFM's intent to defraud in violation of 18 C.F.R. § 1c.1 for three reasons. First, staff is not alleging that NFM violated Cheyenne's Tariff. Rather, staff alleges that NFM violated 18 C.F.R. § 1c.1. The fact that NFM did not violate Cheyenne's Tariff is irrelevant when examining its conduct through the prism of section 1c.1. To argue otherwise would lead to absurd results because it would render 1c.1, the Commission's anti-fraud "catch-all" useless. Second, even if the pipeline representative were provided all the relevant information including NFM's intent in bidding multiple affiliates (which she was not), in no case is a pipeline employee in a position to opine on the legality of another company's conduct under the Commission's regulations or to make statements binding on the Commission. As such, Krape's inquiry to the pipeline does nothing to defeat NFM's intent to manipulate the open season. Third, as noted, there is nothing *per se* unlawful about multiple-affiliate bidding. However, when, as here, those multiple affiliates are employed for the purpose of securing a corporate parent more capacity, at the expense of other bidders, staff believes that violates 18 C.F.R. § 1c.1.

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[70] Krape at 43:15.

[71] Krape at Exhibit 1.

NFM deliberately caused four bids to be placed for available capacity for the benefit only of NFM, thus intentionally increasing NFM's share of the awarded *pro rata* capacity at the expense of other bidders.

NFM's post-hoc explanations for its conduct, that NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering bid to enhance their brand recognition among producers to show that each had the wherewithal to provide service to deliver their gas to various markets, is at odds with both the facts of the case and common sense. In her deposition, Mayland, NFM's CFO and Treasurer, testified as follows:

> Q: So in this circumstance [Cheyenne], NFM Midstream, NFM Texas Gathering, NFM Texas Pipeline bid to acquire additional capacity along with National Fuel Marketing Company?
>
> A: Yes.
>
> Q: Is the purpose of that to acquire more capacity for the company than National Fuel Marketing could acquire by itself had if it were to bid alone?
>
> A: That's the way it worked, yeah, and to provide more reliability to our customers.[72]

The facts here are that NFM, and not NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering, acquired all of the gas at the Cheyenne receipt point. NFM entered into the hedges. NFM held title to the gas transported on the capacity acquired by NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering. NFM provided the credit enabling NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering to bid for the capacity. NFM also sold all of the gas at the Cheyenne delivery point. If NFM's intent was really to showcase the wherewithal of NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering, then it would not have stood in front of its affiliates at every step of the bidding and subsequent transactions. Further, no mention of this supposed plan was made by Krape and Mayland in their depositions despite the opportunities staff afforded NFM counsel to ask any follow-up questions it wished on the record.

c. In connection with

The sale of interstate pipeline capacity falls squarely within the Commission's

[72] Mayland at 27:7-8.

jurisdiction, and NFM's bids to acquire such capacity. It is settled law that the Commission's NGA jurisdiction extends to interstate pipeline transportation rights, regardless of who holds them. *See, e.g.*, *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1152 (D.C. Cir. 1996). As such, NFM's bids and related transactions are in connection with natural gas transportation subject to the jurisdiction of the Commission.

2. Shipper-Must-Have-Title Requirement

As stated above, it is long-standing Commission policy that a shipper must hold title to the gas being transported on the shipper's pipeline capacity.

NFM engaged in violations of the "shipper-must-have-title" requirement by using the capacity awarded its affiliates to ship gas titled to NFM. In so doing, NFM undermined the Commission's goal that the markets subject to its jurisdiction be well-functioning. NFM's violations of the "shipper-must-have-title" requirement are connected to its violation of 18 C.F.R. § 1c.1. Krape testified (and staff later verified with documents) that NFM bought and held title to all of the gas transported, but transported the gas on capacity acquired by NFM Midstream, NFM Texas Gathering and NFM Texas Pipeline.[73] NFM's "shipper-must-have-title" violations are thus further evidence that the only purpose for the bids of NFM Midstream, NFM Texas Gathering and NFM Texas Pipeline was to secure more capacity on which NFM could transport gas.

NFM's violations of the "shipper-must-have-title" requirement are similar to those of Calpine Energy Services, L.P. (CES).[74] CES violated the "shipper-must-have-title" requirement by transporting gas to which it held title using capacity rights of other Calpine affiliates.[75] And like CES, NFM's violations are attributable to relevant personnel lacking knowledge of the "shipper-must-have-title" requirement. In the case of NFM, the CFO and Treasurer, Mayland, stated in her deposition: "Let me clarify that in the Tariff of the [Cheyenne] pipeline, it says that the shipper has the right to ship but doesn't have title."[76] In fact, Original Sheet No. 251 of the General Terms and Conditions section of Cheyenne's FERC Gas Tariff, which went into effect on November 22, 2004, provides the following provision relating to the ownership of gas:

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[73] Krape at 32:1-5.

[74] *In re Calpine Energy Services, L.P.*, 119 FERC ¶ 61,125 (May 9, 2007).

[75] *Id*. at P 8 of the attached Stipulation and Consent Agreement.

[76] Mayland 38:21-23.

GENERAL TERMS AND CONDITIONS
(Continued)

8. CONTROL AND POSSESSION OF NATURAL GAS

8.1 As between Transporter and Shipper, Transporter shall be deemed to be in control and possession of the Natural Gas from the time it is delivered to Transporter at the receipt point(s) until it is redelivered to Shipper at the delivery point(s), and Shipper shall be deemed to be in control and possession of the Natural Gas at all other times. *By tendering gas to Transporter, Shipper warrants that it has title to, or the right to ship, the gas it has delivered.* (emphasis supplied).

VI. Sanctions

A. Civil Penalties

After considering all of the factors set forth in section 22(c) of the NGA, 15 U.S.C. § 717t-1(c), and the Commission's Revised Policy Statement on Enforcement,[77] staff recommends that maximum penalties be assessed against NFM for its violations of 18 C.F.R. § 1c.1. In the following paragraphs, staff addresses the factors we considered in determining whether a civil penalty should be imposed and, if so, the amount of that penalty. Staff also recommends a civil penalty be assessed for NFM's violations of the "shipper-must-have-title" requirement.

1. Nature and Seriousness of the Offense

As required by the NGA, one of the broad categories of factors we consider in determining the amount of a civil penalty is the nature and seriousness of a violation.[78] In this case, NFM's violations, which came to the attention of staff via the Enforcement Hotline, were deliberate and intentional. NFM employed its subsidiaries as a device, scheme or artifice to defraud. Fraud is among the most serious of violations because it is the sort of conduct that, if unchecked, can cause loss of confidence in the markets the

[77] *Enforcement of Statutes, Regulations, and Orders*, 123 FERC ¶ 61,156, at P 54-71 (2008) (Revised Enforcement Policy Statement).

[78] 15 U.S.C. § 717t-1 (added by EPAct 2005, § 314(b)).

Commission regulates. In this case, NFM's bidding on Cheyenne defeated the otherwise efficient and transparent functioning of the *pro rata* allocation mechanism, which is designed to ensure fair distribution among shippers placing the same value on the available capacity.

The harm caused by NFM's fraud was an artificial allocation of scarce and valuable capacity. This distortion meant that some 20 other legitimate bidders received less capacity than they should have, which necessarily means they lost business opportunities as a result of the fraud.

As it maintains it did nothing wrong, NFM has not made any effort to remedy the harm, a statutory consideration set forth in section 22(c) of the NGA. NFM does not have a history of violations, but has engaged in multiple-affiliate bidding in other open seasons.

Although not a large company, the proposed penalty would not imperil NFM's continued financial viability.

2. Cooperation

Initially, counsel for NFM impeded staff's investigation by, *inter alia*, refusing to provide requested documents produced in the ordinary course of business. NFM later changed counsel, and from that time on demonstrated satisfactory, but not exemplary cooperation with staff's investigation.

3. Reliance on Staff Guidance

NFM does not claim to have relied on staff guidance in its bidding in the March 2007 Cheyenne open season.

As mentioned throughout, staff believes that the bids by NFM, NFM Midstream, NFM Texas Pipeline, and NFM Texas Gathering are the transactions that violate 18 C.F.R. § 1c.1. As the bids occurred on a single day, and involve a total universe of four transactions, staff recommends a penalty of $1,000,000 for each of the four companies, for a total penalty for market manipulation of $4,000,000.

Staff also believes NFM's multiple daily violations of the "shipper-must-have-title" requirement warrant a civil penalty. Here, staff has also considered the precedent developed in the contact of capacity release settlements. While the volumes of gas transported are *de minimis*, staff believes the violations of the "shipper-must-have-title" requirement were a means by which NFM was able to perfect its fraud. As such, staff believes NFM's violations of the "shipper-must-have-title" requirement warrant a civil penalty of $500,000. Together then, staff recommends total civil penalties of $4,500,000

be assessed against the NFM entities.

B. Disgorgement

Notwithstanding the fact that the March 2007 Cheyenne open season involved valuable capacity, NFM lost $28,553 on the transactions.[79] Staff has verified this fact. On September 16, 2007, Cheyenne experienced a fire at a compressor station. After the fire, NFM could not ship any volume on Cheyenne for the period September 17 through 19, 2007. NFM also incurred losses on its financial hedge positions, which NFM could not recover through the physical flow of gas.[80] For October, NFM elected not to utilize its incremental Cheyenne transport on a baseload basis. Accordingly, because of its business decisions, NFM incurred losses on otherwise profitable capacity. As such, NFM did not reap unjust profits, and staff does not recommend disgorgement from NFM's use of the capacity it and its affiliates obtained.

As mentioned above, staff investigated several entities in connection with bidding on Cheyenne. Among those investigated are entities with which staff has resolved its investigation via settlement. As part of the settlements, two entities will be disgorging unjust profits derived from their bidding on Cheyenne. In an order staff expects will be issued simultaneously with this report, staff anticipates the Commission will approve the settlement agreements directing these entities to disgorge those unjust profits to the other entities that bid in the Cheyenne open season. Among those entities will be NFM and its affiliates. NFM is expected to receive payments because, at the time such payments will be made to NFM and other open season participants, the Commission will not yet have determined whether or not NFM violated 18 C.F.R. § 1c.1 or the "shipper-must-have-title" requirement in connection with its bidding on Cheyenne. Therefore, staff recommends that if the Commission ultimately determines that NFM did violate 18 C.F.R. § 1c.1 or the "shipper-must-have-title" requirement, then NFM should be required to disgorge those payments it receives from settling parties, plus interest, to the remaining open season participants.

VII. Recommended Action

Based on the above conclusions of law and fact, Enforcement recommends the Commission issue the NFM entities an Order To Show Cause why they did not violate 18 C.F.R. §1c.1 and the "shipper-must-have-title" requirement in connection with their bids for, and transportation using, capacity acquired in the March 2007 Cheyenne open

[79] Data Response No. 4 (May 23, 2008).

[80] Data Response Nos. 3 and 4 (May 23, 2008).

season, and why the Commission should not require the NFM entities to pay a civil penalty of $4,500,000 and disgorge payments received in settlement with other parties, plus interest.

Staff recommends the Commission make Enforcement Staff's Report and Recommendation, unredacted and unedited, public pursuant to 18 C.F.R. §1b.20, thereby affording NFM the opportunity to respond to staff's findings of fact and conclusions of law.

Staff believes the Commission should reserve judgment on whether to set the matter for an evidentiary hearing before an Administrative Law Judge (ALJ). The Commission should have the opportunity to consider NFM's response to an Order to Show Cause before deciding what, if any matters, merit an evidentiary hearing before an ALJ. For example, based on NFM's response, the Commission may determine that only the issue of scienter under 18 C.F.R. § 1c.1 warrants an evidentiary hearing.

In accordance with 18 C.F.R. § 385.213 (2008), staff recommends the Commission direct:

(a) NFM, within 30 days of the date of an Order To Show Cause, be required to file an answer showing why it should not be found to have violated 18 C.F.R. § 1c.1 with respect to the March 2007 Cheyenne open season.

(b) NFM to show cause, no later than 30 days from the date of an Order to Show Cause, why the Commission should not assess a civil penalty pursuant to the Commission's authority under the NGA in the amount of $4,500,000 and order NFM to disgorge unjust profits from payment received from settling parties in the Cheyenne matter, plus interest.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

National Fuel Marketing Company, LLC — Docket No. IN09-10-000
NFM Midstream, LLC
NFM Texas Pipeline, LLC
NFM Texas Gathering, LLC

(Issued January 15, 2009)

MOELLER, Commissioner *dissenting*:

As I stated twice last year, "[t]hose who are subject to Commission penalties need to know, in advance, what they must do to avoid a penalty."[1] This order violates that principle of fundamental fairness, and that is why I dissent.

This Commission administers its statutory responsibilities and makes policy through its orders and rules, and these orders and rules are enforced by our Enforcement Office. If a regulated entity violates our orders or rules or the articulated policies and interpretations associated with those orders and rules, it may be subject to penalties – sometimes severe penalties. However, our rules and policies must be made known to the regulated community in advance. This Commission should not impose penalties in the range of millions of dollars for conduct that reasonably may be viewed as consistent with Commission policy.

With respect to this proceeding, the Commission has had a longstanding policy on whether interstate pipelines should allow affiliated companies to bid during certain open seasons. This policy provides that during those open seasons, affiliates may bid on pipeline capacity. This policy has controlled the process for seventeen years. In relevant part, in 1991 we stated:

> [W]e do not read [the open season bidding] procedures as prohibiting [the pipeline] from accepting separate bids from a parent shipper and its affiliates, as long as each affiliate (which is a separate entity under law) submits one bid.[2]

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[1] *See* Concurring Opinions of Commissioner Moeller in *Enforcement of Statutes, Regulations, and Orders*, 123 FERC ¶ 61,156 (2008) and *Compliance with Statutes, Regulations, and Orders* 125 FERC ¶ 61,058 (2008).

[2] *Pacific Gas Transmission Co.,* 56 FERC ¶ 61,192 at 61,721 (1991).

Upon my review of this policy, I agree that it needs to be changed.

In the investigation that led to this proceeding, the Enforcement Office learned that numerous shippers were relying on the Commission's policy on affiliate bidding when they structured their bidding on pipeline capacity. Presumably these shippers decided that the additional business risk of having their affiliates bid was outweighed by the potential reward of bidding with those affiliates. In fact, an executive for one of the shippers believed that the bids would be "in the money."[3]

Of course, the belief that a bid will be in the money depends entirely on the market price of gas at both ends of the pipeline, and the business skill of the shipper to minimize the cost of moving gas from its point of purchase to its point of sale.[4] In fact, the open season was not "in the money" for at least one group of affiliates, as that group lost money on their bids.[5] This loss appears to be related to a fire at a compressor station, an obvious risk of shipping natural gas on pipelines. Given these risks, even when affiliate bids are permitted, some shippers will conclude that affiliate bidding would involve too great a risk of financial loss. In fact, not all shippers in the industry bid on every open season – even when that open season is widely expected to be "in the money." Shippers obviously exercise their business judgment when deciding whether to bid, and when deciding how many of their affiliates to bid.

In their investigation, the Enforcement Office also learned that numerous shippers were not using their affiliates to bid. Some of these shippers complained to the Commission, as they believed that affiliate bidding could constitute fraud.[6] Perhaps these shippers were not aware of the 1991 order establishing the Commission's policy, or perhaps they wanted to change that policy.

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[3] See the Enforcement Staff Report and Recommendation in Docket No. IN09-9-000 dated December 31, 2008 (Seminole Report) at 12; also see the Enforcement Staff Report and Recommendation in Docket No. IN09-10-000 dated December 31, 2008 (NFM Report) at 13, stating that NFM's "analysis showed a favorable spread."

[4] Staff says that capacity in an open season can be in "high demand" when, for example, low-cost gas originating in the Rockies can be moved to higher-priced markets in the mid-continent. See the Seminole Report at 23, NFM Report at 26.

[5] NFM Report at 35-36.

[6] Seminole and NFM Reports at 8.

At some point in their investigation, the staff in the Enforcement Office concluded that during a recent open season on the Cheyenne Pipeline, the bidders that followed the policy on affiliate bidding should be penalized millions of dollars. Three of my colleagues agree with this conclusion.

The Commission's order in this proceeding is based on the allegations in the staff reports.[7] I have similarly reviewed those reports, but I find fundamental flaws with them.

I. While I could support staff's new definition for "legitimate" bids, the staff did not disclose that definition to the bidders until after they engaged in bidding.

The staff reports find that the 1991 precedent on affiliate bidding is consistent with a Commission requirement that staff could decide after-the-fact which bids were "legitimate".[8] The staff then finds that an affiliate bid is legitimate if the affiliate needed the capacity to serve wholesale customers or retail customers of the affiliate, or if the affiliate needed the capacity to transport gas owned by the affiliate. This presumably means that taking on the risk of financial loss by bidding on capacity in an effort to make a profit is not legitimate. Perhaps this means that a bidder cannot release capacity once received, as any such release would violate the requirement that the capacity be used for gas owned by the affiliate or to serve customers of the affiliate. And if every affiliate in a group of affiliates needs to submit legitimate bids, then all bidders must submit legitimate bids, even if their bid was not submitted with a group of affiliates.[9]

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[7] See the orders to show cause in Dockets No. IN09-9-000 and IN09-10-000 at P3. As stated on page 6 of the NFM and Seminole Reports, the Commission was able to consider other information regarding the orders to show cause. That is, on January 2, 2009, Enforcement Staff delivered NFM's and Seminole's submissions to the Commission that were dated December 5, 2008. In addition, and at my request, on January 9, 2009 Enforcement Staff made available to the Commission copies of the 18 CFR § 1b.19 letters that were sent to Seminole on November 5, 2008 and NFM on October 31, 2008.

[8] Seminole Report at 22-23; NFM Report at 25.

[9] The staff reports do not appear to have addressed the legitimacy of bidders who did not bid with their affiliates. Do these bidders need to meet the same standards of legitimacy? That is, does every bidder need to have capacity to serve their own wholesale customers or retail customers, or to transport gas that they own?

While I could support staff's interpretation for "legitimate" bids (after that definition was appropriately clarified and explained), staff's interpretation was not disclosed to the bidders on the Cheyenne open season until after they learned that staff sought millions of dollars in penalties from them.

The outcome of this investigation stands in great contrast to a recent case involving allegations in the oil industry that shippers were over-nominating the volume of oil that they could ship on an oil pipeline. In that case, decided less than three weeks ago, a unanimous Commission supported efforts by an oil pipeline to change its rules to "discourage the practice of shippers nominating excessive volumes." The Commission accepted a "Batch Verification Procedure" that would require shippers to identify upstream barrels to correspond with the batch they nominate on the pipeline.[10] Notably, we did not find that shippers were engaged in fraud if they previously nominated in excess of identifiable upstream volumes. But even without allegations of fraud, the Commission was free to change its policy and improve the process for the future.

The Director of our Enforcement Office recognizes that Commission guidance has the most impact on reducing the violations of our rules, and also recognizes that sometimes this Commission should not impose penalties even when a company has clearly violated our rules. In reference to an audit of the Southern Star Central Gas Pipeline,[11] she stated that the Commission "has the most impact, when it indicates … it has chosen not to impose a penalty, but [instead tells] other similarly situated companies that it perhaps would not tolerate such conduct in the future."[12] In Southern Star, we did not penalize the company despite serious violations, rather "we decided to forego that remedy and instead address[ed] the company's violations in a Commission order to provide guidance to other companies similarly situated to Southern Star."

II. The Commission did not take the opportunity to change its policy when it failed to act on the 2002 open seasons conducted by the Trailblazer Pipeline.

In 2002, shippers on the Trailblazer Pipeline complained to the staff about fraud when several shippers exercised their right to bid with affiliates during a series of open

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[10] *CCPS Transportation, LLC*, 125 FERC ¶ 61,394 (2008).

[11] *Southern Star Central Gas Pipeline, Inc.*, 125 FERC ¶ 61,082 (2008).

[12] See the transcript of the Commission's open meeting on November 20, 2008 at 32. That transcript also contains Commissioner statements on our enforcement policy at 21-26.

seasons. Staff believes that the publicity about affiliate bidding on the Trailblazer Pipeline should have informed shippers that the Commission granted staff the authority to define "legitimate" bids after-the-fact. In fact, the Commission declined to address the issue of legitimate bidding after the Trailblazer open seasons, even though the Commission was faced with the very issue. That is, when the Trailblazer Pipeline argued that it would "have no basis for distinguishing between legitimate and illegitimate bids by affiliated entities," the Commission did not provide any definition for "legitimate", nor did it explain that staff was authorized to define "legitimate" bids after-the-fact.[13] For that reason, bidders were not aware that the Commission would hold that bids were not legitimate when a bidder risked financial loss by bidding on capacity in an effort to make a profit.

As part of its investigation of Trailblazer's open season process, staff asked Trailblazer to notify the industry that bidders could "game" auctions by using affiliate bids.[14] Yet notification by a pipeline is not equivalent to a Commission order – and the

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[13] *Trailblazer Pipeline Co.*, 103 FERC ¶ 61,225 at P 71 (2003), *order on reh'g and compliance filing*, 108 FERC ¶ 61,049 (2004).

[14] Seminole Report at 24. Here is the notice, in full:

> As the result of an informal complaint to the FERC following a recent capacity release on the Trailblazer system, Trailblazer has been requested by the FERC Market Oversight and Investigations staff to include the following announcement in this capacity release open season:
>
> The Market Oversight and Investigations (OMOI) staff of the FERC is monitoring open seasons for capacity releases on Trailblazer. Based on information related to recent open seasons, OMOI staff believes that bidders may be able, through the use of affiliated bidders, to game auctions of released capacity in which several bids have an equal Winning Bid Value, so that the capacity is awarded on a pro rata basis pursuant to Section 19.10(d) of the General Terms and Conditions of Trailblazer's tariff. Accordingly, OMOI staff is monitoring situations in which a number of affiliated entities each make bids at the maximum rate for the same released capacity and release term, especially when such bids are followed by a prearranged re-release to a single affiliate or a small number of affiliates that were awarded released capacity by Trailblazer. To determine whether any remedial action relating to this open season is appropriate, OMOI staff may seek information on a non-public basis from entities that

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notice did not prohibit the practice of affiliate bidding. Moreover, even if Trailblazer's notice was sufficiently prohibitive, Staff observes in its report that "it is a well-settled principle that the Commission speaks through its orders, not the absence thereof."[15] A pipeline's notice, even if at the request of staff, is not equivalent to an order of this Commission.

The industry appears to have recognized that a pipeline notice was not equivalent to a Commission order, as a group of shippers requested that the Commission change its policy on affiliate bidding so that all affiliate bids would be evaluated as if they were one bid. Despite this request, the Commission twice declined its opportunity to act.[16] By not acting, the Commission continues to be bound by its policy established in 1991.

III. The Commission did not take the opportunity to change its policy when it issued regulations for certain open seasons conducted under section 103 of the Alaska Natural Gas Pipeline Act.

To further argue that the staff may determine the legitimacy of a bid after-the-fact, staff points to open season regulations under section 103 of the Alaska Natural Gas Pipeline Act (the Alaska Act). According to the order adopting those regulations, the Commission said that it was not prohibiting affiliate bidding, but that it would "examine closely any such bids to determine whether they are soundly based on satisfying the legitimate needs of the bidder, or whether they are made to 'game' the open season process."[17] Besides the fact that open seasons outside of Alaska are not conducted pursuant to the regulations established under section 103 of the Alaska Act,[18] the

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make such bids.
This notice was posted on October 22, 2002 at 5:22:39 PM.

[15] Seminole Report at 24; NFM Report at 27.

[16] *Trailblazer Pipeline Co*., 103 FERC ¶ 61,225 at P 99 and P102 (2003), *order on reh'g and compliance filing*, 108 FERC ¶ 61,049 at PP 40, 42, and 46 (2004).

[17] *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects,* Order No. 2005, FERC Stats. & Regs., ¶ 31,174 at P 99, NFM and Seminole Reports at 4.

[18] See 18 CFR § 157.32 (2008), which provides in full:

> These regulations shall apply to any application to the Commission for a certificate of public convenience and necessity or other authorization for an Alaska natural gas transportation project, whether filed pursuant to the Natural Gas Act, the Alaska Natural Gas Transportation Act of 1976, or the Alaska

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Commission in that order did not provide even a hint that legitimate bids on a different type of pipeline could only consist of bids where the affiliate needed the capacity to serve wholesale customers or retail customers of the affiliate, or bids where the affiliate needed the capacity to transport gas owned by the affiliate. Thus, even under the assumption that our orders on pipelines regulated under the Alaska Act are controlling here, the bidders engaged in a reasonable interpretation of legitimate. Moreover, I doubt that staff's interpretation for "legitimate" should apply in the context of Alaska pipelines, which further supports the reason why the Alaska pipelines are considered differently under our rules.

IV. Fraud almost universally requires a concealment or misrepresentation, an allegation absent from staff's reports.

According to its open season rules, Cheyenne publicly released the results of its open season. In fact, the very word "open season" includes the word "open" to specifically describe an open process. The Cheyenne open season was clearly "open", as at least five bidders reviewed the open bids, saw the bidding by affiliates, and complained about fraud in telephone calls to the Commission.[19] Staff's report agrees with those allegations, concluding that certain bids were fraudulent. Yet fraud almost universally involves an allegation of concealment or misrepresentation[20] – an allegation absent from staff's reports.

Natural Gas Pipeline Act, and to applications for expansion of such projects. Absent a Commission order to the contrary, these regulations are not applicable in the case of an expansion ordered by the Commission pursuant to Section 105 of the Alaska Natural Gas Pipeline Act.

[19] Seminole and NFM Reports at 8.

[20] Black's Law Dictionary, Bryan Garner, Ed. (West Group, Seventh Edition, 1999). But see the NFM Report at 20, which says that "NFM's bids were submitted in secret … [i]t was not until Cheyenne posted the results of the open season … that NFM's fraud became visible." Based on this, perhaps staff might contend that concealment includes the failure to disclose bids until after the bidding is opened. If that were correct, then every last bidder in the open season would be "guilty" of concealment since the pipeline conceals all bids until they are open (pursuant to the pipeline's rules for its open season).

V. Shippers should not be required to pay millions of dollars in penalties for conduct that may reasonably be viewed as consistent with Commission policy.

The Commission has the authority under the Natural Gas Act to establish policy related to its jurisdiction. Yet we should not penalize a company millions of dollars for conduct that reasonably may be viewed as consistent with Commission policy. Instead, we should change our existing policy so that bidders have advance notice of when they can legitimately submit bids during an open season.

I respectfully dissent.

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Philip D. Moeller
Commissioner