January 15, 2009
Docket No. IN09-10-000
Item No. G-4

Commissioner Philip D. Moeller

Statement of Commissioner Philip D. Moeller on National Fuel Marketing Company, LLC Enforcement Action

"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]

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

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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).

[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.

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.

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]

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

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[5] NFM Report at 35-36.

[6] Seminole and NFM Reports at 8.

[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?

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 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

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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.

[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

equivalent to a Commission order – and the 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 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

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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 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 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.

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.

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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[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).