Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?

Testimony of the Honorable Joseph T. Kelliher
Chairman
Federal Energy Regulatory Commission
Before the
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
United States House of Representatives

December 12, 2007

Introduction and Summary

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to speak with you today about the Federal Energy Regulatory Commission's (FERC or Commission) role in protecting energy consumers against price manipulation in wholesale energy markets. Because of the critical role that energy plays in our economy and in the welfare of our nation's citizens, it is imperative that regulators have the necessary tools to protect energy consumers. I welcome the Subcommittee's review of these important issues.

FERC is an independent agency charged with regulating wholesale sales and transportation or transmission of natural gas and electric power, rates for oil pipelines, approval for new interstate energy facilities and licensing and safety for non-federal hydroelectric projects.

However, at heart FERC is a consumer protection agency. Our primary task since the 1930s is to guard the consumer from exploitation. Historically, we have done that by ensuring that jurisdictional wholesale rates for natural gas and electric energy are just, reasonable and not unduly discriminatory or preferential. We are charged under the Natural Gas Act and the Federal Power Act with regulating certain wholesale sales of natural gas and electric energy in interstate commerce, as well as transportation of natural gas and transmission of electric energy in interstate commerce.

Today my comments will focus primarily on our natural gas rate regulation and the steps FERC has taken to ensure the integrity of wholesale gas markets and prevention of market manipulation under the new authorities granted to it under the Energy Policy Act of 2005. However, I note that our authorities to protect customers against market manipulation generally are parallel under both the Natural Gas Act and Federal Power

Act. Manipulation in gas markets can also affect the price of electricity for consumers since natural gas is a key input to the cost of many electric power facilities.

FERC has adapted its regulations over the years to rely on a mixture of competition and regulation where possible to produce just and reasonable prices for wholesale energy customers, but to apply cost-based regulation where competition does not exist or where market power can be exercised. The Energy Policy Act gave FERC important new regulatory authorities to enhance its ability to protect natural gas and electric energy customers. I thank the Committee for supporting FERC's request for this additional regulatory authority two years ago and credit the Committee for recognizing that FERC needed new regulatory tools to discharge its historical duty to guard the consumer.

In particular, the Energy Policy Act amended our statutes in several significant ways to protect against market manipulation.

First, it amended both the Natural Gas Act and Federal Power Act to explicitly prohibit entities from engaging in deceptive or manipulative conduct in connection with FERC-regulated energy markets and authorized us to implement rules to enforce this prohibition. Second, it directed us to facilitate price transparency in jurisdictional markets and gave us authority to require any market participant to disseminate information about the price and availability of natural gas and electric energy and the transportation and transmission of those products. Third, it gave FERC enhanced civil penalty authority under both the Natural Gas Act and Federal Power Act. These tools provide FERC the foundation for a strong enforcement program to protect energy consumers.

We acted quickly to exercise the new regulatory powers Congress gave us to guard the consumer. In the wake of the Energy Policy Act, I established the Office of Enforcement at FERC. That office is charged with monitoring energy markets and with conducting investigations of possible violations of FERC rules, including our anti-manipulation rule. Significantly, the staff of the Office of Enforcement meet every day to discuss market developments over the prior 24 hours. In particular, they discuss price movements, and have the ability to initiate investigations in the event they identify price movements that do not appear consistent with market fundamentals. My testimony discusses the FERC market oversight and enforcement program in more detail.

As we monitor energy markets and protect against market manipulation, it is important to understand that price formation in sophisticated energy markets has become increasingly complex. Regulators must understand and consider the interplay between financial and futures energy markets, on the one hand, and physical energy markets, on the other hand. While FERC has jurisdiction over physical wholesale gas sales, and the Commodity Futures Trading Commission (CFTC) has jurisdiction over futures, the link

between futures and physical markets cannot be overstated. In a sense, these markets have effectively converged. Manipulation does not recognize jurisdictional boundaries and we must be vigilant in monitoring the interplay of these markets if we are to adequately protect consumers.

When Congress passed the Energy Policy Act, it recognized the convergence of physical and futures energy markets and the need for FERC and CFTC to cooperate in their market oversight and regulation. The Act required the two agencies to enter into a memorandum of understanding (MOU) to share market information. I note that the two agencies accelerated their development of the MOU in the wake of Hurricanes Katrina and Rita, in order to improve coordination during a period of great volatility in natural gas prices. This is one of the Energy Policy Act deadlines that FERC exceeded. The MOU has worked extremely well with respect to information sharing and coordination of investigations and I want to reassure the Subcommittee that the recent disagreement between the two agencies with respect to the scope of FERC's anti-manipulation authority has in no way undermined the cooperation and effective interaction of the staffs of the two agencies. The two agencies continue to share market information and coordinate on a number of important investigations.

At this time I do not believe FERC needs any additional legal authority to protect consumers from market manipulation. You gave us the tools we needed two years ago. However, it is important that those tools not be taken away from us or diminished.

Energy Policy Act of 2005

FERC's core mission has remained the same for 70 years: to protect natural gas and electric power consumers from exploitation. But energy markets changed significantly since the 1930s. FERC reacted to those developments by changing its approach to regulation over time. Ultimately, it became apparent that we needed new regulatory tools to discharge our historical duty to guard the consumer from exploitation and we sought additional regulatory authority from Congress.

The experience of the Western energy crisis of 2000-2001 showed that energy consumers were exposed to the threat of market manipulation. Yet, market manipulation was not explicitly barred by either the Natural Gas Act or the Federal Power Act. FERC also lacked adequate civil penalty authority to assure compliance with both tariffs and market rules governing wholesale natural gas and power markets. I personally argued in favor of additional authority in these and other areas because I believed we could not otherwise adequately discharge our duty to protect consumers.[1]

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[1] Hon. Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26:1 Energy L.J. 1 (2005); 108 CONG. REC. S13,999 (daily ed. Nov. 5, 2003) (statement of Sen. Cantwell introducing letter from

The Energy Policy Act granted FERC express authority to prohibit market manipulation. It also prescribed an underlying definition for market manipulation based on the long-standing precedent of the Securities Exchange Act of 1934. This provides a strong grounding for our efforts to oversee wholesale energy markets. We exercised this authority quickly, issuing proposed anti-manipulation rules two months after enactment of the Energy Policy Act, and making a final rule effective on January 26, 2006, making the rule effective immediately on an emergency basis. Within six months after you enacted the anti-manipulation provisions of the Energy Policy Act, we had fully implemented this new authority.

The Energy Policy Act also gave FERC greater authority to assure the transparency of wholesale energy markets. The transparency provisions gave us the authority to increase the amount of market information available to market participants and observers. We have exercised this authority as well. In proposed rules issued earlier this year, FERC proposed two changes that would increase the transparency of wholesale natural gas markets. The first change would require intrastate pipelines to post more information about physical flows on their systems, which would allow the market better to assess supply and demand trends. The second change would require annual reporting by wholesale natural gas buyers and sellers that would let us determine the overall level of index-based trading and activity in markets that set price indices. This second change would better allow FERC, market participants and others to assess the size of physical wholesale natural gas markets.

Before the Energy Policy Act, FERC did not have all the tools it needed to be a strong enforcement agency. The penalties we could apply to violations were largely limited to disgorgement of profits. The Energy Policy Act increased our civil penalty authority to $1 million per day per violation and greatly expanded the scope of violations subject to FERC civil penalties.

There were other important provisions of the Energy Policy Act that granted FERC significant regulatory authority. For example, Congress expanded our merger authority, which improves our ability to prevent the accumulation of market power. I will not discuss these provisions, since they do not directly relate to the subject of the

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FERC nominee Kelliher and pointing out his agreement that "markets subject to manipulation cannot operate properly and there is an urgent need to proscribe manipulation of [energy] markets"); *Market Manipulation Penalties*, Dow Jones, Feb. 17, 2003 (describing FERC nominee Kelliher's concern about need for anti-manipulation legislation and expanded FERC penalty authority).

hearing today. However, the Energy Policy Act clearly reflected a judgment by Congress that natural gas and electric power markets had changed significantly since the 1930s, and FERC needed additional regulatory authority to discharge its historical duty to guard the consumer. In my view, the Energy Policy Act represents the largest single grant of regulatory authority to FERC since the New Deal. You gave us the tools we needed.

Implementing the Energy Policy Act: Anti-Manipulation

The Energy Policy Act certainly provided FERC with needed new authorities. It also gave us a substantial to-do list with ambitious deadlines. I am proud that the Commission implemented all the provisions of the Energy Policy Act within those deadlines. We met every deadline you set for us – and even beat a few. We also were careful in the manner we implemented the new authorities granted by Congress two years ago.

In January 2006, we issued Order No. 670, a final rule implementing regulations to prevent market manipulation in wholesale power and gas markets and in transmission and transportation services. In my view, this provision of the Energy Policy Act was among the most important and challenging to implement.

We were careful in our approach. The anti-manipulation provision of the Energy Policy Act directed FERC to adopt the statutory model in section 10(b) of the Securities Exchange Act of 1934, rather than the anti-manipulation provision administered by the CFTC. We studied the securities model and adapted it where necessary to our legal construct. We also studied the anti-manipulation provisions in commodities law, which in turn is also modeled on the Securities Exchange Act of 1934. In the end, we modeled our rule closely on Securities Exchange Commission rules implementing section 10(b). We believe this approach makes germane the substantial body of precedent with respect to the 1934 Act.

The anti-manipulation regulations promulgated in Order No. 670 closely follow the language of the Energy Policy Act. Under our final rules, it is unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or transmission services subject to FERC jurisdiction, or the purchase or sale of natural gas or transportation service subject to FERC jurisdiction, to (1) use or employ any device, scheme, or artifice to defraud, (2) make material false statements of fact or omit material facts, or (3) engage in any act, practice or course of business that operates or would operate as a fraud or deceit on any person.

That provides FERC structure to identify market manipulation and also gives market participants the information they need to discipline their own behavior. Importantly, consistent with the Energy Policy Act, these rules apply not only to public utilities and natural gas companies, but also to any entity that commits a fraud affecting

jurisdictional transactions. "Public utility" and "natural gas company" are defined terms in federal electricity and natural gas law since the 1930s, meaning companies that engage in jurisdictional sales or provide jurisdictional transmission or transportation service. Yet Congress provided that our anti-manipulation authority apply not just to companies that engage in jurisdictional sales or provide jurisdictional service, but to "any entity" that engages in manipulation "in connection with" such sales or services. We have interpreted "any entity" to be a much broader category than "public utility" and "natural gas company," an interpretation which we believe to be consistent with Congressional intent.

Implementing the Energy Policy Act: Enforcement

The Energy Policy Act permanently changed FERC – turning us into an enforcement agency with significant civil penalty authority. We have used the new authority carefully and have developed a strong track record of enforcement over the past two years.

In October 2005, we issued a Policy Statement on Enforcement, establishing a general approach of "firm but fair" enforcement. To assure fairness, the Policy Statement provided that we would consider mitigating factors in determining penalties in any particular case, including whether the company reported its own violation, how committed it was to its compliance programs, and how well it cooperated with FERC during an investigation.

We also established a new process for "No Action Letters" for certain types of issues. This lets companies seek informal staff advice as to whether staff would recommend an enforcement action with regard to a particular transaction, practice or situation.

Moreover, we recently held a Conference on Enforcement Policy to assess the agency's implementation of its Energy Policy Act enforcement authority. We heard a variety of proposals for improving our processes from all parts of the industry. We will consider these proposals carefully in the coming months.

Since October 2005, FERC Enforcement staff has closed or completed 64 investigations. In 47 of these cases, we assessed no penalty either because there was not enough evidence of a violation or because the violation was not serious enough to warrant a sanction. The Commission has approved twelve settlements of investigations that resulted in the companies paying $39.8 million in penalties, filing compliance plans, and taking other remedial actions. We have exercised prosecutorial discretion to concentrate our enforcement resources on the most significant violations that pose the greatest threat to consumers.

In two key cases, we have issued Orders to Show Cause and Notices of Proposed Penalties. Under these orders, FERC made preliminary findings that two groups of companies and individual traders (collectively, Amaranth and Energy Trading Partners) may have manipulated energy markets. These orders do not represent final determinations and make no final conclusions. Both groups of respondents have been given the opportunity to rebut the preliminary conclusions set forth in the orders. Energy Transfer Partners has filed its answer, while Amaranth's answer is currently due December 14. If the final conclusions reflect the preliminary findings, we propose to impose penalties that approach the maximum for certain violations – $291 million for the Amaranth entities and $167 million for the Energy Transfer Partners entities, for total civil penalties of $458 million.

Amaranth and Energy Transfer Partners Investigations

Before I discuss the Amaranth and Energy Transfer Partners investigation, it is important to offer a few comments about natural gas transactions. Natural gas is traded in a wide variety of products. Some of these products are physical products potentially subject to FERC jurisdiction. Other products are futures or financial products subject to CFTC jurisdiction. Pricing of these products can be quite complicated. Natural gas futures in the United States are traded on the New York Mercantile Exchange (NYMEX). By contrast, many products, both physical and financial, are negotiated bilaterally, some online through brokers like the IntercontinentalExchange (ICE). For buyers and sellers interested in market prices, but not interested in trading themselves, physical next-day and next-month prices are collected by the trade press and used to construct price indices. As discussed below, along the East Coast and the Gulf Coast, monthly indices are constructed using transactions with prices set, in part, by settling futures prices. As a result, futures prices determine, in part, the price of physical natural gas purchased by customers. In addition, ICE supports trade of a financial swap, which is otherwise known as a "look-alike" swap, that sets its price based in the futures settlement price. These transactional links between futures and physical and futures and financial prices proved especially important in the Amaranth investigation, as discussed below.

The Amaranth investigation began when FERC Market Oversight staff noticed peculiar trading patterns in the close of the NYMEX futures contract for May 2006. In particular, prices fell dramatically toward the end of the last half hour of trading, which determines the final settlement price for the monthly contract. I credit the vigilance of FERC Market Oversight staff in identifying these patterns.

Of course, the CFTC has jurisdiction over the regulation of NYMEX markets. But the pattern of trading was important to us because a large number of monthly contracts for physical natural gas are pegged to the monthly NYMEX close, so that every penny change in the NYMEX close flows directly into the physical price.

To understand the relationship between futures prices and physical natural gas prices, it is necessary to recognize that some futures contracts become physical natural gas contracts, or, in the terms of the industry, "go to delivery." In addition, there is a class of monthly physical transactions (called physical basis transactions) that tie their prices directly to the settled futures price. These transactions are so common along the East Coast and the Gulf of Mexico that monthly indices in these regions depend almost entirely on physical basis transactions. The attached map shows the regions affected. In that way, the NYMEX contract closing price not only affects physical basis deals themselves, but also all deals that are linked to local indices. Thus, the effects on physical markets of changes in futures prices are direct and significant.

Based on the evidence developed in the investigation, we made a preliminary finding that Amaranth may have deliberately obtained and then sold large futures positions in the last half hour of trading on the settlement date in order to manipulate prices downward. Thus, Amaranth may have benefited from even larger, opposing positions they held on ICE, and that they did all this fully knowing that their actions would affect physical prices as well. Downward manipulation of the monthly futures contract would have benefited their financially settled swaps.

To be clear, we do not believe that Amaranth engaged in any FERC jurisdictional sales. Amaranth did not seemingly seek to manipulate monthly futures prices in order to obtain a benefit from the sale or purchase of physical products. We believe they may have manipulated monthly futures prices in order to benefit from the settling swaps and to influence the value of other positions within their portfolio. However, manipulation of the monthly futures price can affect physical gas sales, given the direct setting of contracts that go to delivery and the widely understood price relationship relating to physical basis and indices.

The Energy Transfer Partners case began when Commission staff received a call on its Enforcement Hotline, alleging that the market for monthly physical gas at the Houston Ship Channel was manipulated on September 28, 2005. Based on the evidence from the investigation, we made a preliminary finding that Energy Transfer Partners dominated physical fixed-price gas sales at Houston Ship Channel and may have manipulated the reported index price. Despite its sales at Houston Ship Channel, Energy Transfer Partners was consistently a net buyer of physical gas from contracts linked to the Houston Ship Channel index. Thus, Energy Transfer Partners may have manipulated the index price downward to benefit its overall portfolio of purchases and other financial positions.

Cooperation with the CFTC

In both the Amaranth and Energy Transfer Partners cases, we began an investigation and shared our information fully with the CFTC. The CFTC began its own investigations of both matters soon thereafter.

The two agencies cooperated closely throughout the investigations. As noted, the CFTC and FERC had entered into an MOU to ensure that we share information quickly and effectively. The MOU worked well throughout the fourteen months of the Amaranth investigation and the twenty-one months of the Energy Transfer Partners investigation, and continues to do so. The two agencies conducted parallel investigations that were closely coordinated.

This cooperation was significant. As described above, the Amaranth investigation examined possible manipulation of futures price to obtain a benefit from positions held in financial products. CFTC has jurisdiction over futures. Any such manipulation would affect physical natural gas consumers, given how the monthly futures price is used to price physical gas transactions. FERC is charged with protecting physical natural gas consumers. By contrast, the Energy Transfer Partners investigation involved possible manipulation of FERC jurisdictional physical natural gas sales to obtain a benefit from positions in other physical and financial products. In a sense, one investigation examined manipulation that may have occurred within CFTC jurisdiction and affected FERC jurisdictional sales. The other involved manipulation that may have occurred within FERC jurisdiction that affected other CFTC jurisdictional transactions. Both investigations involved possible manipulation that may have crossed the jurisdictional lines between the two agencies. Cooperation between FERC and CFTC is essential in order to police this type of manipulation.

In the end, the CFTC initiated action against Amaranth on July 25, 2007, and against Energy Transfer Partners on July 26, 2007. We initiated action against both parties on July 26, 2007. The enforcement actions were coordinated, as were the investigations themselves. Both agencies publicly praised the investigations conducted by the other agency.

Litigation on Amaranth Jurisdiction

Amaranth has raised arguments about whether FERC has jurisdiction over manipulation of the monthly futures price. Even before we issued our Order to Show Cause, Amaranth's lead trader, Brian Hunter, filed in the United States District Court for the District of Columbia seeking to enjoin issuance of the order, claiming FERC lacked jurisdiction. Judge Richard Leon denied the request for a temporary restraining order, at which point the litigation became an effort on Hunter's part to prevent further proceedings under the Order to Show Cause. The ruling in this matter has not yet issued.

Within weeks after the Order to Show Cause, Amaranth filed a motion to stay FERC's action in the civil action filed by the CFTC against Amaranth in the U.S. District Court for the Southern District of New York (under our respective statutes, the CFTC brought its enforcement action in court, while we proceeded administratively). Amaranth argued, among other things, that we lack jurisdiction and CFTC has sole jurisdiction over the conduct described in our Order to Show Cause. Although CFTC opposed Amaranth's motion to stay our order, the CFTC maintained that it had exclusive jurisdiction over all trading in natural gas futures. This would have the effect of preempting FERC's ongoing enforcement proceeding against Amaranth. I consider this to have been a significant change in the CFTC position.

On November 1, Judge Chin denied Amaranth's motion, holding, among other things, that under the Natural Gas Act, any review of our jurisdiction must be conducted in a court of appeals.

At this point, the two agencies have a difference of opinion about the proper interpretation of the anti-manipulation provisions of the Energy Policy Act, and how these provisions should be interpreted in concert with the Commodity Exchange Act. This disagreement will likely be resolved by the courts. In this regard, we recently issued an order addressing Amaranth's legal arguments on FERC's jurisdiction. Attached to my testimony is a copy of our order, which details our interpretation of the anti-manipulation provision.

There is a great deal at stake in this legal dispute. The key issue is the reach of FERC's anti-manipulation authority, the extent of our ability to protect consumers. If the attack on our jurisdiction is successful, our ability to guard the consumer from exploitation would be significantly reduced. As I stated earlier, our fundamental duty is to guard the consumer. We would not be able to sanction manipulation of CFTC-regulated futures markets that affects physical gas sales under our jurisdiction. We would not be able to discharge our duty effectively, as Congress has a right to expect.

FERC and CFTC are different agencies, with different duties. We are a consumer protection agency. The CFTC has a different mission. We have greater penalty authority than the CFTC, and are more likely to order disgorgement of profits in a market manipulation case, which holds out the promise to consumers that they can be made whole. It is also much harder for the CFTC to prove manipulation than FERC because they operate under a higher statutory standard. As a result, the CFTC is more likely to charge attempted manipulation, while FERC is more likely to charge manipulation. That is borne out by the Amaranth litigation.

I think consumers see a difference. That is why the national association of state regulators and a host of individual state commissions have declared support for FERC's

position. They have even gone so far as to enter the litigation, filing briefs in the New York district court supporting FERC. Perhaps the best judge is the consumers themselves. Various consumer groups, including the American Public Gas Association, the American Public Power Association, and the National Electric Rural Cooperative Association also filed briefs there in support of the FERC position.

We recognize the CFTC has exclusive jurisdiction to regulate aspects of futures trading, such as the terms or conditions of sale of futures contracts, the operating rules of NYMEX, or traders' commodity accounts, and we recognize the importance of the futures markets. The CFTC focuses its efforts on regulating instruments related to futures and financial products and making sure that designated contract markets, such as NYMEX, operate properly. FERC respects the CFTC's exclusive jurisdiction in these areas and we do not seek to regulate futures or regulate the exchanges, nor do we seek to bar entities from trading as CFTC does. However, the CFTC is charged with protecting the integrity of futures markets, not energy markets.

In our order denying rehearing, we stand by our position that Amaranth's activities fall within our jurisdiction insofar as they affected physical sales of natural gas. Amaranth does not dispute that physical sales were affected. The statute provides that: "It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the sale of transportation service any manipulative or deceptive practice (as those terms are commonly used in section 10(b) of Securities Exchange Act of 1934 …." We believe that this language gives FERC broad authority to sanction manipulative conduct where it significantly affects jurisdictional sales. Comments in the floor debate on the Energy Policy Act clearly indicate Congress's intent that FERC implement the broadest possible prescriptions necessary to protect energy consumers.

The reference to "any entity" shows Congress's intent to capture not only natural gas companies historically subject to FERC jurisdiction under the Natural Gas Act, but also anyone else that engages in prohibited behavior that affect jurisdictional physical sales. Congress could have limited the expanse of FERC anti-manipulation authority to "natural gas companies." It did not do so. It chose a much broader term, namely "any entity." We must conclude that decision was deliberate and meaningful.

We also believe that the "in connection with" language in the statute indicates Congress intended an expansive definition of the activities we could sanction. Congress could have prohibited only manipulation that occurs in Commission-jurisdictional markets. It chose instead the more expansive language. It is hard to imagine what "in connection with" could mean if it does not cover conduct that clearly and substantially affects prices in physical markets under our jurisdiction. In fact, should the courts decide that we do not have jurisdiction, our ability to protect customers, as contemplated in the Energy Policy Act, would be substantially impaired.

Finally, we believe that, under the Energy Policy Act, FERC and the CFTC each have exclusive jurisdiction over the day-to-day regulation of their respective physical and financials markets. But where manipulation in one market directly or indirectly affects the other, both agencies have an enforcement role. This is a dual role that Congress intended and that will redound to the benefit of all market participants in the end.

Cooperation Continues

I regret that this disagreement between FERC and the CFTC has arisen in recent months. But I want to be clear that this disagreement over jurisdiction has not impeded cooperation between the two agencies. We have a respectful disagreement over interpretation of the anti-manipulation provisions of the Energy Policy Act, a disagreement that in my view is best resolved by the courts.

I also want to be clear that I do not question the CFTC's commitment to preventing market manipulation – they are as committed to preventing market manipulation as we are. They have demonstrated that by continuing to cooperate with FERC on matters of mutual interest, notwithstanding their legal opinion on the scope of our jurisdiction.

The disagreement has not impeded cooperation between the two agencies on ongoing investigations of mutual interest. Our MOU continues in place, and we continue to coordinate our information gathering. Staff members from the two agencies continue to meet periodically to discuss more general issues of common interest. And the two agencies are discussing other ideas on how to improve cooperation in investigations and enforcement.

Maintaining Access to Market Data

FERC oversees natural gas and electric markets vigilantly every day, using all of the information available to it. The Amaranth case arose because our analysts saw an anomaly in NYMEX trading as it was happening during the monthly close.

Several legislative proposals are currently circulating that would close what is called the "Enron loophole" and give the CFTC jurisdiction over ICE and other electronic trading venues that provide significant price discovery. Unless carefully crafted, these proposals could affect our ability to oversee natural gas and electric power markets, because many of these venues trade physical as well as financial contracts.

ICE is a good example. Some analysts have referred to ICE as a "dark market." Our experience is different. ICE produces a great deal of information about current and forward markets for both natural gas and electric power all over the United States.

Indeed, ICE is our leading source of information about a large part of the physical market for both commodities, especially in real-time. The attached graph shows the kind of detailed information that we have contracted to see every day from ICE, including the timing, volume and price of all the relevant transactions that occurred on ICE that day. In this case, the graph shows daily physical trading at Henry Hub for delivery on November 29, 2007. We do not see counter-party information, except when we undertake an investigation. But we can and do get such information under our subpoena power when needed.

Please note that in the attached graph, all of the transactions are for physical delivery of natural gas on the following day. It is true that most ICE transactions are for financial products – 95 percent of total trading. In fact, we track the transactions on ICE of their futures look-alike swap to give us additional context for natural gas price development. Far more important for us, most of the information we can see about many of our physical markets comes from the other five percent of trading on ICE. Also, some financial transactions, such as basis swaps, are central to setting many physical prices. Any delay or limitation on our access to this information would significantly diminish our Enforcement efforts.

The general point is that individual market venues, like ICE, frequently trade both physical and financial products. It is very important for us to maintain our current level of authority over, and information access to, the physical aspects of those market venues.

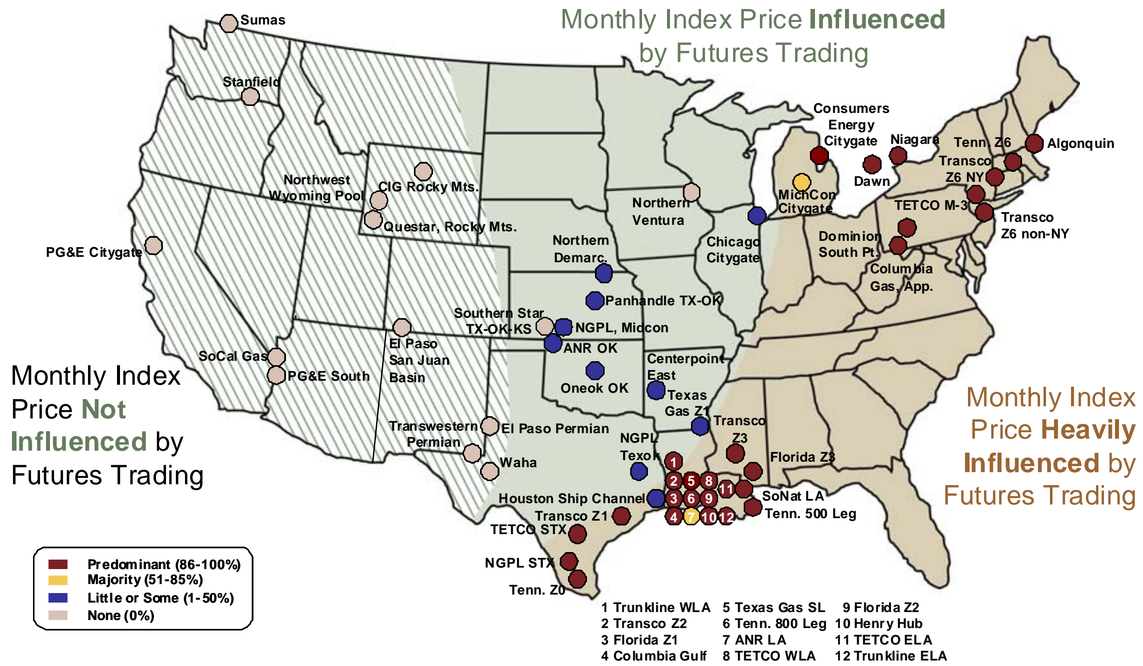
Conclusion

The Energy Policy Act gave us the tools we need to oversee physical natural gas and electric power markets. Over the last two years, we have moved both carefully and quickly to implement the relevant parts of the Energy Policy Act – especially the anti-manipulation, civil penalty, and transparency authorities.

Our experience so far is that the new authorities give us what we need to penalize and deter price manipulation. Our track record shows how effective those authorities can be. I do not anticipate that we would need further authorities.

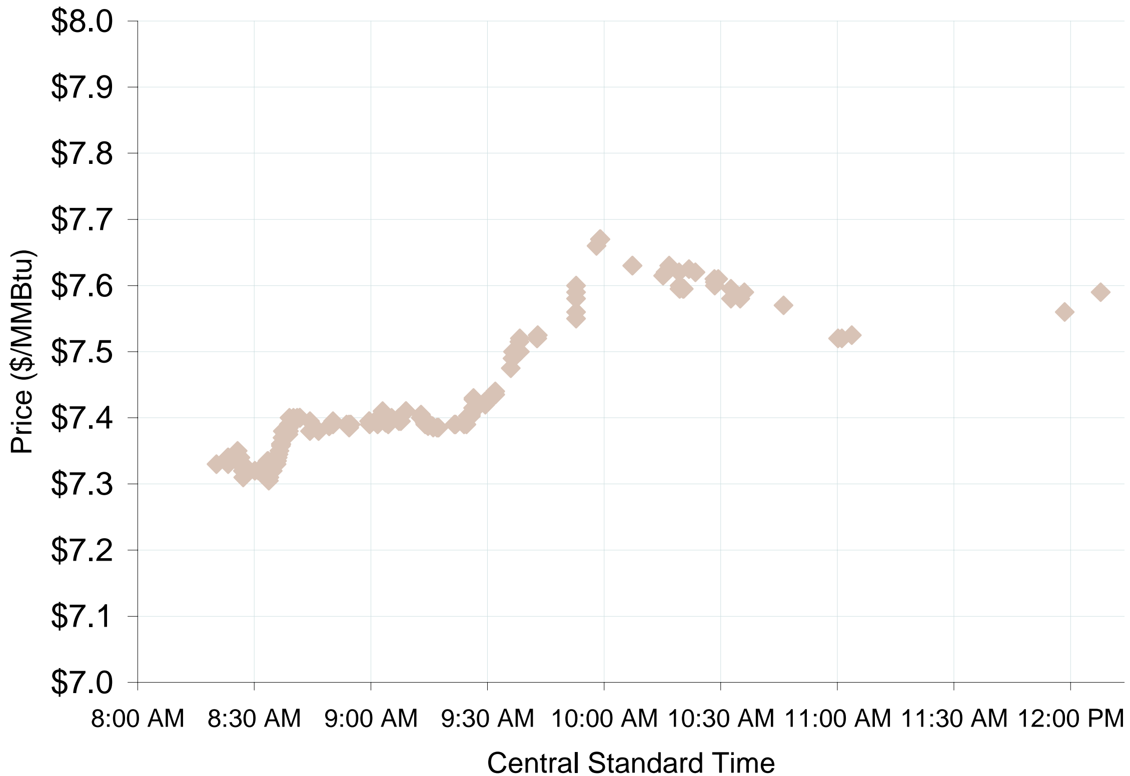
However, a legal question has arisen regarding one of our most important new regulatory authorities – our ability to prevent and sanction market manipulation. We believe it is important to clarify the extent of FERC authority to prevent market manipulation. There is much at stake in this dispute. If the courts were to agree with the position taken by Amaranth, FERC's ability to protect consumers would be significantly impaired.

Figure 1: Use of Physical Basis in Natural Gas Price Indices at Major Trading Points, 2007



Source: Derived from *Platts* data for January through October 2007 indices.

Figure 2: ICE Daily Physical Natural Gas Prices at Henry Hub, Flow Date 11/27/2007



Note: Every point represents one transaction

APPENDIX

121 FERC ¶ 61,224
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.

Amaranth Advisors L.L.C. Docket No. IN07-26-001
Amaranth LLC
Amaranth Management Limited Partnership
Amaranth International Limited
Amaranth Partners LLC
Amaranth Capital Partners LLC
Amaranth Group Inc.
Amaranth Advisors (Calgary) ULC
Brian Hunter
Matthew Donohoe

ORDER DENYING REHEARING

(Issued November 30, 2007)

1. This order addresses whether the Commission has authority under section 4A of the Natural Gas Act (NGA) to sanction manipulative trading of natural gas futures contracts when it finds that such manipulative trading had a nexus to and significant effect on the prices of Commission jurisdictional wholesale sales of natural gas. On July 26, 2007, the Commission issued an Order to Show Cause (OSC) to the above ten Respondents, directing them to show why they had not violated section 4A of the NGA and section 1c.1 of the Commission's regulations, 18 C.F.R. §1c.1 (2006) (Anti-Manipulation Rule) as well as to show cause why they should not be assessed civil penalties and be required to disgorge unjust profits, plus interest. On August 27, 2007, four of the ten Respondents, Amaranth Advisors, L.L.C., Amaranth Advisors (Calgary) ULC, Amaranth Management Limited Partnership, and Amaranth Group (collectively "Amaranth") filed a request for expedited rehearing of the OSC (Rehearing Request). Amaranth seeks to terminate the OSC proceeding because it claims that the Commission lacks subject matter jurisdiction over Amaranth's alleged manipulation. As discussed

below, the Commission denies Amaranth's rehearing request.[2] Some of the other six Respondents also filed requests for rehearing of the OSC but their rehearing requests are not addressed in this order. They will be addressed in a future order.[3]

I. Background

A. The Order to Show Cause

2. In the OSC, the Commission preliminarily concluded that Amaranth's trading in Natural Gas Futures Contracts (NG Futures Contracts) had a direct and substantial effect on the price of Commission-jurisdictional transactions, affecting natural gas customers and ratepayers across the United States, both of which the Commission is required by statute to protect.[4]

3. Amaranth traded in NG Futures Contracts[5] on the New York Mercantile Exchange (NYMEX). Trading NG Futures Contracts creates a "settlement price," which is the volume-weighted average price of trades made during the last 30 minutes of trading (typically from 2:00 p.m. to 2:30 p.m.) on the third-to-last business day of the month preceding the next calendar month. The Commission detailed in the OSC preliminary findings that Amaranth appears to have manipulated (in this case driving down) the settlement price of NG Futures Contracts by selling an extraordinary amount of NG

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[2] On October 12, 2007, the Commission extended the date for responses to the OSC to fourteen days after the Commission's ruling on Amaranth's Request for Rehearing. Pursuant to that Notice, Respondents shall now answer the OSC, as specified in P 140(a) and (b) of the OSC, not later than 14 days from the issuance of this Order.

[3] We are disposing of Amaranth's rehearing request in its entirety. We will address issues raised in rehearing requests by other Respondents, such as the authority to assess civil penalties, the construction of the term "any entity" as to individuals, or the liability of such Respondents, in a future order.

[4] *See generally Order to Show Cause*, 120 FERC ¶ 61,085 (July 26, 2007) (OSC).

[5] NG Futures Contracts are standardized contracts that specify the terms under which a buyer will accept and a seller will deliver a specified quantity of natural gas at a specified place and over a specified month in the future. Typically, NG Futures Contracts provide for the future delivery of 10,000 MMBtus of natural gas over the course of the contract month to the buyer's interconnection on the Henry Hub in Louisiana. *See* Natural Gas Futures Contracts, NYMEX Exchange Rulebook §§ 220.05, 220.10-12, http://www.nymex.com/rule_main.aspx?pg=33#220.05 (last visited Sept. 14, 2007).

Futures Contracts during the last 30 minutes of trading before the contracts expired.[6] Considered in isolation, Amaranth's trading could be economically irrational because it made less on the sales of these contracts. However, because Amaranth took positions several times *larger* in various financial derivatives whose value *increased* as a direct result of the decrease in the settlement price of NG Futures Contracts, Amaranth could have gained on its overall financial positions.

4. The Commission also explained that NG Futures Contracts are not purely financial instruments because some futures contracts traders take their contracts "to delivery," meaning they hold the contracts into the month during which the contract becomes a contract for actual purchase and delivery of 10,000 MMBtus' of natural gas at the Henry Hub delivery point in Erath, Louisiana.[7] The price of that *physical* natural gas transaction is the NG Futures Contracts settlement price. In addition, "physical basis" transactions are based on the NG Futures Contracts settlement price.[8] The NG Futures Contracts settlement price is directly incorporated into many published price "indices," which are relied upon by physical buyers and sellers as a benchmark to determine the prevailing price for natural gas at a given location, or a specified differential to a published price index in the event the gas is to be delivered at a different location.[9] Therefore, the Commission explained, Amaranth's actions, if proven to have driven down the NG Futures Contracts settlement price, had a direct and substantial effect on the price of several different types of *physical* natural gas transactions – transactions that are indisputably within the Commission's jurisdiction.[10]

5. If the NG Futures Contracts settlement price was driven down by Amaranth's trading, sellers who went to delivery on short NG Futures Contracts, as well as producers and other natural gas market participants, may have been paid an artificially lower price for their natural gas. Such manipulation undermines confidence in and integrity of energy markets that are critical to supporting an adequate natural gas infrastructure and

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[6] OSC at PP 84, 91 and 106.

[7] *Id.* at PP 5, 26.

[8] *Id.* at P 20.

[9] *Id.* at PP 21-24. To compile monthly "indices" of those prices at various physical natural gas trading locations, publishers of natural gas industry newsletters (*e.g.,* Platts or NGI) conduct price surveys of market participants. Those surveys capture a significant amount of the aforementioned physical basis transactions. *See generally Policy Statement on Natural Gas and Electric Price Indices*, 104 FERC ¶ 61,121, *clarification granted*, 105 FERC ¶ 61,282 (2003).

[10] OSC at PP 20-27, 108-10.

that provide consumers reasonable prices for natural gas. Finally, the pecuniary interests of state and federal governments may have been harmed when natural gas from public lands was sold for royalties that are also tied to the NYMEX settlement price.

6. The Commission preliminarily concluded in the OSC that Amaranth and the other Respondents violated the Commission's Anti-Manipulation Rule, which was adopted pursuant to section 4A of the NGA, 15 U.S.C. § 717, as amended by the Energy Policy Act of 2005, Pub. L. No. 109-58, § 315 (2005) (codified at 15 U.S.C. 717c-1) (EPAct 2005). It proposes that Amaranth pay civil penalties and disgorge unjust profits under similarly new enhanced penalty provisions also added to the NGA by EPAct 2005.[11] It also ordered responses to the OSC's specific allegations. Amaranth sought leave, and it and all other Respondents have been permitted, to file responses to the OSC within fourteen days after this ruling.

B. Amaranth's Request for Expedited Rehearing on the Issue of the Commission's Jurisdiction

7. Amaranth's rehearing request generally raises the issue of the Commission's subject matter jurisdiction to proceed with its OSC under section 4A of the NGA. New section 4A was added to the NGA, along with a parallel provision which was added to the Federal Power Act (FPA), by EPAct 2005. It provides as follows:

> It shall be unlawful for *any entity*, directly *or indirectly*, to use or employ, *in connection with* the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, *any* manipulative or deceptive device or contrivance (as those terms are used in section 10(b) of the Securities Exchange Act of 1934 . . .in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers. (emphasis added).

8. In support of its Rehearing Request, Amaranth raises three principal points of error. First, Amaranth contends that section 4A of the NGA does not confer jurisdiction on the Commission to regulate trading of futures that takes place exclusively on the NYMEX because such transactions are within the "exclusive jurisdiction" of the Commodity Futures Trading Commission (CFTC).[12] Amaranth contends that the CFTC has exclusive jurisdiction to regulate manipulation within financial markets, even if such conduct directly and substantially impacts the Commission's jurisdictional natural gas

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[11] *Id*. at P 75.

[12] Rehearing Request at 13-16.

markets. Amaranth maintains that the EPAct 2005 amendments to the NGA did not expand the Commission's jurisdiction to include trading "solely" in natural gas futures that affects Commission-jurisdictional markets and that there is no jurisdictional overlap between the Commission and CFTC because the Commodity Exchange Act, P.L. 74-765, 49 Stat. 149 (1936) (CEA) grants the CFTC "exclusive jurisdiction . . . with respect to accounts, agreements and transactions involving contracts for the sale of a commodity for future delivery."[13] Amaranth cites legislative history from 1974 to support its claim that the Commission is preempted from regulating futures markets.[14] In further support of this argument, Amaranth claims that the "savings clause" in section 23 of the NGA (a natural gas market transparency provision which was added to the NGA by EPAct 2005), confirms that Congress did not expand the Commission's jurisdiction to include manipulation of futures contracts, but instead withheld regulatory power from the Commission by re-affirming the CFTC's exclusive jurisdiction under the CEA.[15] According to Amaranth, decisions holding that two agencies may conduct separate investigations are inapplicable because the CFTC has exclusive jurisdiction over the claims at issue.[16] Amaranth also contends that section 23 gave the Commission authority only to collect from market participants and disseminate information about the availability and prices of natural gas sold at wholesale in interstate commerce.[17] According to Amaranth, the related requirement that the Commission enter into a Memorandum of Understanding (MOU) with the CFTC is intended to ensure only that information requests are coordinated, and not to authorize the Commission to take regulatory action.[18]

9. Second, Amaranth argues that the Commission exceeded its jurisdictional bounds, principally because the "in connection with" language of section 4A of the NGA does not confer subject matter jurisdiction over the types of futures transactions addressed by the OSC.[19] While the Commission stated in the OSC that EPAct 2005 expanded its authority to police all forms of manipulation in connection with its jurisdictional markets, Amaranth contends that the "in connection with" language in section 4A of the NGA

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[13] 7 U.S.C. § 2(a)(1)(A) (2000). *See generally* Rehearing Request at 16-25.

[14] Rehearing Request at 15.

[15] *Id.* at 16-21.

[16] *Id.* at 24-25.

[17] *Id.* at 17-18

[18] *Id.* at 18-19.

[19] *Id.* at 26-39.

added by EPAct 2005 did not confer upon the Commission jurisdiction to regulate so-called "non-jurisdictional" activity or entities even if the actions affect Commission-jurisdictional markets.[20] Because Amaranth was not itself a party to the purchase or sale of physical natural gas contracts, Amaranth claims the manipulation alleged by the Commission was not "in connection" with Commission-jurisdictional transactions. Specifically, Amaranth maintains that, our statements in the OSC notwithstanding, section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(b) (2000) (Securities Exchange Act) and cases applying that provision, do not guide the analysis of whether the NG Futures Contracts transactions were "in connection with" physical natural gas markets because the Commission was not given the enforcement powers provided in section 10(b).[21] According to Amaranth, Congress only meant to incorporate into section 4A the definitions of certain *terms* used in section 10(b). Alternatively, if statutory construction of the "in connection with" clause of section 10(b) is applicable to NGA section 4A, Amaranth contends that legal precedent supports its position that Amaranth would be subject to the Commission's jurisdiction only if Amaranth traded in physical natural gas that "coincided with" or was "in furtherance" of the manipulative scheme.[22] Because Amaranth claims it did not engage in such transactions, it asserts that the "in connection with" element is not satisfied.

10. Third, accepting its own interpretation of the EPAct 2005 and the NGA, Amaranth argues that our Order No. 670 adopting the Anti-Manipulation Rule[23] likewise stated that we do not regulate fraud and manipulation in "non-jurisdictional" transactions, such as NG Futures Contracts.[24] Amaranth recites language from Order No. 670 which it claims is inconsistent with our preliminary conclusions in the OSC. From there, Amaranth contends the Commission's OSC is arbitrary, capricious, and an abuse of discretion because we failed to explain why we "departed" from our determination in Order No. 670.[25]

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[20] *Id.* at 26-31.

[21] *Id.* at 31-32.

[22] *Id.* at 34-36.

[23] *Prohibition of Energy Market Manipulation*, Order No. 670, 71 Fed. Reg. 4244 (January 26, 2006), FERC Stats. & Regs. ¶ 31,202 (codified at 15 U.S.C. 717c-1) (Order No. 670).

[24] Rehearing Request at 39-41.

[25] *Id.* at 41

II. Commission Determination

11. As the Supreme Court has held, the primary purpose of the NGA is to "protect consumers against exploitation. "[26] The Commission is required by statute to ensure that certain physical sales of natural gas sales are just, reasonable and not unduly discriminatory or preferential under the NGA and that natural gas consumers are thereby protected.[27] Beginning in the 1980s, the Commission regulated jurisdictional wholesale sales of natural gas on a market basis and thus its responsibility to assure just and reasonable rates is fulfilled by ensuring that natural gas markets remain competitive. In the OSC we preliminarily determined that Amaranth's manipulative trading of NG Futures Contracts, which are not directly regulated by the Commission on a day-to-day basis, nevertheless had a direct effect on the price of natural gas sales which are within the Commission's jurisdiction.[28] Because of this direct effect on jurisdictional sales, the behavior fell within the NGA section 4A prohibition of direct or indirect manipulation in connection with jurisdictional sales. In making our preliminary findings in the OSC, we took into account the CFTC's exclusive jurisdiction to oversee the operation of the futures markets.[29] The Commission neither asserted jurisdiction over day-to-day regulation of CFTC-regulated futures contracts transactions nor sought to interfere with that jurisdiction. Rather, as we stated in the OSC, the Commission's jurisdiction over activities that affect its markets is complementary to the CFTC's jurisdiction over the activities that affect futures markets.[30]

12. As discussed in detail below, the statutory language of NGA section 4A, in conjunction with Congress' recognition of the overlap in FERC and CFTC regulated markets in the NGA section 23 transparency provision that was enacted simultaneously by Congress, supports the Commission's interpretation. Further, the historical context in which Congress considered the NGA section 4A and parallel FPA section 222 amendments supports the interpretation that Congress intended the Commission to ensure that there is no regulatory gap in sanctioning manipulative behavior affecting jurisdictional gas and electric markets. The result of our interpretation is that although the Commission and the CFTC each have exclusive jurisdiction over the day-to-day regulation of their respective physical energy and financials markets, where, as here,

[26] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

[27] 15 U.S.C. § 717t-2(a)(1) (2000).

[28] OSC at PP 108-10.

[29] *Id.* at PP 48, 55.

[30] *Id.* at PP 48.

there is manipulation in one market that directly or indirectly affects the other market, both agencies have an enforcement role. This is a dual role that was contemplated by Congress, that should be coordinated and consistent wherever possible, and that, in the end, will redound to the benefit of all market participants.

A. The Commission's NGA Section 4A Jurisdiction

13. Although presented as the second point in Amaranth's "specification of errors," the question of whether the Commission has jurisdiction, in light of the "in connection with" language of NGA section 4A, or otherwise, is the most fundamental issue presented (regardless of the CFTC's jurisdiction). Accordingly, we turn to that question first and, after resolving that question, we turn to Amaranth's other arguments, as necessary.

14. Before addressing Amaranth's jurisdictional arguments, we note four basic factual points that were contained in the OSC and are, at this point in the proceedings, undisputed by Amaranth:

a. Amaranth does not dispute that the alleged manipulation in this case involves three interrelated markets: (1) the NG Futures Contracts market; (2) a variety of "derivative" financial products; and (3) Commission-jurisdictional wholesale natural gas sales, namely, wholesale natural gas sales in interstate commerce that are not "first sales" within the meaning of the Natural Gas Policy Act of 1978 (NGPA).[31] Amaranth does not dispute that the first market affects the second and third inasmuch as the NG Futures Contracts settlement price determines, in whole or in part, the value of the derivatives and the price of a substantial volume of Commission-jurisdictional wholesale natural gas sales.[32]

b. Amaranth does not dispute that the "settlement price" attaches to any NG Futures Contracts that becomes a contract for the sale of physical natural gas. During the months of interest in this matter, blanket certificate holders such as ConocoPhillips, BP, Louis Dreyfus, UBS, and Merrill Lynch each sold natural gas by holding more than 2,000 NG Futures Contracts through expiration in one or more of the months for approximately 20 billion cubic feet of physical gas that went to delivery.[33] These physical natural gas sales were, in whole or in part, Commission-jurisdictional transactions. Amaranth presents no evidence or argument to the contrary.

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[31] 15 U.S.C. § 3431(a) (2000).

[32] OSC at PP 2, 6, 108-10.

[33] *Id.* at P 25 (*citing* NYMEX open interest, trade, and delivery data, ferc_item13_ng_top_tdr_final2.xls).

c. Amaranth does not dispute that substantial volumes of bid week[34] transactions are "physical basis" transactions that are priced using the NG Futures Contracts settlement price and that such sales are largely Commission-jurisdictional.[35]

d. Amaranth does not dispute that monthly indices at many trading centers are set primarily by physical basis transactions during "bid week" and thus also use the NG Futures Contracts settlement price as a reference price. Amaranth also does not dispute that, in turn such price indices are widely used in bilateral natural gas markets that are subject to the jurisdiction of the Commission.[36] Thus, as Amaranth agrees, the "public relies on the [NYMEX] settlement price" as a "key price benchmarked for physical . . . contracts involving natural gas."[37] Nor does Amaranth dispute that state regulators sometimes look to index or settlement price-based purchases of natural gas by local distribution companies in evaluating whether such purchases were prudent.

1. <u>The Commission's Preliminary Jurisdictional Findings and the Language and Purpose of the Anti-Manipulation Provisions</u>

15. Although the rehearing request offers a number of detailed and specific legal points and authorities, Amaranth's central argument with respect to our jurisdiction is that the NGA and the Anti-Manipulation Rule do not confer jurisdiction on the Commission to prohibit the conduct alleged in the OSC.[38] As with any issue of statutory and regulatory construction, we begin with text and purpose of the statute (including pertinent legislative history), our rule implementing the statute, and our order adopting the rule. We then apply the legal interpretation to the facts at hand.

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[34] "Bid week" is the last five business days of the month. *See generally Policy Statement on Natural Gas and Electric Price Indices*, 104 FERC ¶ 61,121, *clarification granted*, 105 FERC ¶ 61,282 (2003).

[35] OSC at P 22.

[36] *Id.* at 22-23, 25.

[37] Letter from Michael Carrieri, Compliance Director of Amaranth, to Anthony Densieski, Senior Director, Market Surveillance, NYMEX (Aug. 30, 2006).

[38] Rehearing Request at 10-12 (rejecting the OSC findings in PP 44-51 and 108-10).

16. As noted above, section 315 of EPAct 2005 added a new section 4A to the NGA that provides in pertinent part:

> It shall be unlawful for *any* entity, directly *or indirectly*, to use or employ, *in connection with* the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, *any* manipulative deceptive device or contrivance (as those terms are used in section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers. (emphasis added).[39]

17. This language, in particular the broad and general terms used therein, is most reasonably read to give the Commission broad authority to sanction manipulative conduct where, as here, such conduct has a nexus to and significantly affects jurisdictional sales. The language making it unlawful for "any entity" to engage in manipulative conduct in connection with jurisdictional transactions demonstrates Congress' intent to capture not only natural gas companies or other jurisdictional companies historically subject to the NGA but rather any individual, corporation, or governmental or non-governmental entity that engages in the prohibited behavior. The language "directly or indirectly" is reasonably read to prohibit behavior not only by entities engaging in Commission jurisdictional transactions but entities engaging indirectly, for example through intermediaries, in such transactions, or in behavior indirectly affecting such transactions.[40] Similarly, the language "any manipulative device or contrivance" is

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[39] 15 U.S.C. § 717c (2005). With respect to the "subject to the jurisdiction of the Commission" element, section 1(b) of the NGA grants the Commission jurisdiction over "the sale in interstate commerce of natural gas for resale." 15 U.S.C. § 717(1)(a) (2000). The NGPA, 15 U.S.C. §§ 3301 *et seq.* (2000), and the Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157 (1989), exclude from the Commission's NGA jurisdiction all "first sales," 15 U.S.C. § 3431(a) (2000), which are all sales from the producer to the consumer, unless and until the gas is purchased by an interstate pipeline, intrastate pipeline, or local distribution company or an affiliate thereof. 15 U.S.C. § 3301(2)(21)(A) (2000). *See also Amendments to Blanket Sales Certificates*, Order No. 644, FERC Stats. & Regs. ¶ 31,153 at P 14 (2003), *reh'g denied*, 107 FERC ¶ 61,174 (2004).

[40] Cases interpreting section 10(b), which provides that it "shall be unlawful for any person, directly or indirectly," to use any instrumentality of interstate commerce in connection with a manipulative or deceptive device or contrivance, held that the "word 'indirectly' is quite broad and pervasive" and, therefore, use of a telephone to arrange a meeting for purposes of effectuating a fraud satisfies the requirements of section 10(b). *Nemitz v. Cunny*, 221 F. Supp. 571, 573 (N.D. Ill. 1963). Therefore, section 10(b) and Rule 10b-5 have been read to impose liability on any person who participated in a

reasonably read to capture a broad array of manipulative or deceptive conduct that may harm Commission jurisdictional markets and customers. The legislative history of the enactment of this new provision and the parallel provision in the FPA, section 222, supports a reasonably broad interpretation of the Commission's authority to sanction manipulative or deceptive conduct. While the Conference Report accompanying EPAct 2005 does not contain discussion of the anti-manipulation provisions, there is ample discussion in floor debates leading up to EPAct 2005 to demonstrate that Congress intended to confer on the Commission broad authority to prohibit manipulation affecting jurisdictional markets. In floor debates discussing the scope of manipulative practices to be prohibited, two different versions of the anti-manipulation provisions were introduced and considered in May 2005: the "Cantwell Amendment," which sought to add broad anti-manipulation language similar to that of section 10(b) of the Securities Exchange Act and a narrower "Domenici Amendment" that had a specific list of prohibited practices.[41] The broad Cantwell Amendment, modeled on section 10(b), became what is now section 4A of the NGA and section 4A expressly provides that terms common to section 10b and 4A are used in the same manner in section 4A as in section 10(b). Congress then expressly delegated *to the Commission* the task of adopting rules to give life to section 4A.[42]

18. In commenting on the essentially identical electric anti-manipulation provision that was ultimately adopted alongside section 4A, Senator Jeff Bingaman, Ranking Member of the Senate Committee on Energy and Natural Resources when EPAct 2005 was enacted, stated that "we should give FERC this tool and make it clear in the law that all of these deceptive and manipulative practices are illegal. Once we make that clear, we are in a position to hold FERC accountable, if in fact, manipulation or deceptive practices occur in the future."[43]

19. It is reasonable to infer from this statement that, in the aftermath of the manipulative practices by Enron and other companies that were uncovered in connection with the Western energy crisis of 2000-2001, Congress intended to give the Commission the tools needed to sanction future manipulation affecting jurisdictional prices and

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manipulative or deceptive scheme, even if a material misstatement by another person created the connection between the scheme and the securities market. *In re Lernout & Haupsie Sec. Lit.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003).

[41] *See* 151 Cong. Rec. S 7451 at 40 (daily ed. June 28, 2005) (Statement of Sen. Cantwell).

[42] *See* 15 U.S.C. §717(c) (2005) (the "Commission may prescribe as necessary [rules] in the public interest or for the protection of natural gas ratepayers.").

[43] 149 Cong Rec. S 10182 (daily ed. July 30, 2003) (statement of Sen. Bingaman).

services and to rely on the Commission's expertise and knowledge of relevant markets to craft rules that would most fully effectuate the prevention, detection, and punishment of manipulation affecting Commission jurisdictional markets.

20. To implement section 315 of EPAct 2005 and NGA section 4A, the Commission promulgated its Anti-Manipulation Rule, section 1c.1 of the Commission's rules, which prohibits:

> any entity, directly or indirectly, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission [from using] or employ[ing] any device, scheme, or artifice to defraud, [or from engaging in] any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.[44]

21. In adopting this rule, we issued Order No. 670 and expressly ruled the Anti-Manipulation Rule is an intentionally broad proscription against all kinds of deception, manipulation, deceit and fraud.[45] We clarified the following elements of a manipulation claim: "an entity: (1). . .engages 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."[46] Order No. 670 explained that fraud is defined generally to include "any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market."[47]

22. The Anti-Manipulation Rule applies whether or not the manipulator's principal or exclusive purpose is the manipulation of physical natural gas sales. In Order No. 670, we stated "we do not intend to construe the Final Rule so broadly as to convert every common law fraud that happens to touch a jurisdictional transaction into a violation of" the Anti-Manipulation Rule.[48] Yet, such a transaction would be covered if "in committing fraud, the entity . . . intended to affect, or have acted recklessly to affect, a

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[44] 18 C.F.R. § 1c.1 (2006).

[45] Order No. 670 at P 49.

[46] *Id.* at P 50.

[47] *Id.* (*citing Dennis v. United States*, 384 U.S. 855, 861 (1966) (noting that fraud within the meaning of a statute need not be confined to the common law definition of fraud: any false statement, misrepresentation or deceit)).

[48] *Id.* at P 22 (emphasis added).

jurisdictional transaction."[49] We pointed out that the "in connection with" language is drawn from similar language of Rule 10b-5, which has been very liberally construed.[50] Accordingly, we held in Order No. 670 and observed in the OSC that the Anti-Manipulation Rule applies where there is a "nexus" between the manipulative conduct and the jurisdictional transaction. Under the analogous Rule 10b-5 precedent, the alleged manipulator need not be a party to the jurisdictional transaction, nor must the connection be overwhelmingly direct.[51] Finally, we also explained that a determination of manipulation, in general, is "a question of fact that is to be determined by all the circumstances of a case."[52] We note that after significant commentary relating to our notice of proposed rulemaking as to the Anti-Manipulation Rule, there were no appellate challenges to our Final Rule.

23. Based on information developed to date, the Commission preliminarily concluded that Amaranth's manipulation of the NG Futures Contracts settlement price was "in connection with" Commission-jurisdictional transactions.[53] First, the settlement price directly sets the price for any NG Futures contracts that ultimately went to delivery at Henry Hub. As noted, the contracts were substantial in number. This connection is certainly direct. Second, the settlement price is indirectly incorporated into the price for physical basis transactions. Finally, the price of a substantial proportion of physical basis transactions are used in indices, and those indices, in turn, price a substantial volume of physical natural gas. The OSC presented data supporting the conclusion that a significant proportion of these sales are jurisdictional to the Commission. As we noted in the OSC, millions of consumers, particularly on the East Coast, are affected by these prices. Some of these various types of connections are direct, others are indirect. They each vary in magnitude. As discussed below, all of them qualify Amaranth's conduct as "in connection with" Commission jurisdictional transactions.

2. The Language of NGA Section 4(a) as Compared to NGA Section 4A

24. Amaranth contends that the phrase "in connection with" in NGA section 4A

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[49] *Id.* (emphasis added).

[50] *Id.*

[51] As discussed below, the Anti-Manipulation Rule prohibits an entity from "directly or indirectly" committing fraud.

[52] Order No. 670 at P 50.

[53] OSC P 108-10.

should be interpreted identically to the same phrase that appears in NGA section 4(a)[54] (governing the Commission's ratemaking authority) because section 4A's anti-manipulation language "closely tracks" the section 4(a) ratemaking language.[55] In passing, we note that Amaranth's rehearing request makes several additional arguments about the "in connection with" language, including its relationship to other phrases in the Anti-Manipulation Rule, the breadth of the phrase under the securities laws, and the like. Thus, we are called upon to address it from several different perspectives throughout this order.[56] This particular argument rests on the fact that two sections of the NGA, 4A and 4(a), use the phrase "in connection with." Section 4(a) of the NGA provides that:

> [a]ll rates and charges made, demanded, or received by any natural gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.[57]

25. The language of section 4(a) provides the Commission with ratemaking authority over natural gas companies with respect to rates and charges "in connection with" the transportation or wholesale sales of natural gas within the Commission's jurisdiction as defined (and limited) in section 1(b) of the NGA. However, use of the term "in connection with" is where the similarity of the two provisions begins and ends, and the fundamental flaw in Amaranth's argument is that Congress expressly patterned section 4A, including the "in connection with" language therein, on section 10(b) of the Securities Exchange Act, *not* on section 4(a) of the NGA. No one challenged the Commission's statement in Order No. 670 that it would interpret "in connection with" in a manner consistent with section 10(b). Thus it is reasonable to rely on section 10(b) precedent, and not section 4(a) precedent, to interpret the phrase "in connection with." EPAct 2005 does not increase the variety of transactions within the Commission's ratemaking jurisdiction under pre-existing NGA section 4(a). We re-iterate here our findings in the OSC that such a jurisdictional transaction must be directly or indirectly affected by manipulative or deceptive conduct in order for the manipulation or deception to violate the Anti-Manipulation Rule.[58] However, Congress did broaden (with language

[54] Prior to and after EPAct 2005, the NGA has a "section 4(a)." The new Anti-manipulation provision added by EPAct 2005, which did not replace section 4(a), was denominated "section 4A."

[55] Rehearing Request at 36-31.

[56] *See* further discussion *infra* at paragraphs 34-45.

[57] 15 U.S.C. § 717c(a) (2005).

[58] OSC at P 110.

in section 4A that is not present in section 4(a)) the conduct affecting such transactions that the Commission may police, namely manipulative or deceptive conduct by any entity that, either directly or indirectly, is in connection with the purchase or sale of natural gas or transportation services within the Commission's jurisdiction. *See* further discussion *infra* at paragraphs 30-45 and 59.

26. The cases cited by Amaranth for the proposition that "identical words used in different parts of the same act are intended to have the same meaning"[59] did not involve a situation, as here, where Congress amended a statute with a new provision expressly modeled on a provision in another act.[60] The "in connection with" language used in section 4A must be read in the context of the entire section 4A provision. We believe that the differences in the language used in section 4(a) and in section 4A, taken in their entirety, reflect the broad remedial purpose of Congress in enacting section 4A. Thus, it is not only reasonable as a matter of statutory interpretation, but is consistent with congressional intent to interpret each provision (4(a) and 4A) based on the entirety of each provision as a whole. Furthermore, section 4A, which was modeled after the Securities Exchange Act provision, provides that terms common to section 10(b) and 4A (such as "to use or employ, in connection with" and "any manipulative or deceptive device or contrivance in contravention of such rules") should be interpreted as those terms are used in section 10(b), not 4(a).

27. The section 4(a) cases cited by Amaranth supporting its restrictive interpretation of "in connection with" are inapposite. In *Conoco, Inc. v. FERC*, 90 F.3d 536 (D.C Cir. 1996) (*Conoco*), the court held that the phrase "in connection with" appearing in section 4(a) of the NGA did not allow the Commission to regulate gathering facilities because they are expressly exempt from the Commission's jurisdiction in section 1(b) of the NGA, 15 U.S.C. § 717(b) (1994).[61] Similarly, in *Federal Power Comm'n v. Panhandle Eastern Pipe Line Co.*, the Supreme Court ruled that facilities, such as reserves and gas leases used for gas production and gathering, are likewise beyond the jurisdiction of the Commission because they too fall within section 1(b) exemptions.[62] However, "the

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[59] Rehearing Request at 30.

[60] *See Envtl. Def. v. Duke Energy Corp.*, 127 S.Ct. 1423, 1424 (2007) (the same statutory terms used in different parts of the statute may be construed differently in order to satisfy distinct statutory objectives); *Bailey v. United States*, 516 U.S. 137, 145 (1995) (the meaning of statutory language depends on the context in which it is used).

[61] *Conoco*, 90 F.3d at 552 (section 1(b) expressly exempts from the Commission's jurisdiction the gathering of natural gas).

[62] 337 U.S. 498, 504 (1949).

scope of the Commission's power under the inclusive 'in connection' with' language of §§ 4 and 5 [of the NGA] was not at issue."[63] Finally, *Williams Natural Gas Processing-Gulf Coast Co., L.P. v. FERC*, 373 F.3d 1335 (D.C. Cir. 2004) (*Williams*) does not hold, as Amaranth contends, that a gathering affiliate is beyond the Commission's jurisdiction if it does not directly participate in natural gas markets. Rather, the *Williams* holding concerns whether the Commission can disregard the corporate form and reassert jurisdiction over a gathering facility, which is expressly exempt from regulation under section 1(b) of the NGA, because its activities are interrelated to an affiliated interstate pipeline.[64]

28. These decisions simply concluded that section 4(a) could not be construed in a manner that would expand the jurisdiction expressly foreclosed in section 1(b). They did not address (nor could they, since section 4A had not been enacted) the broader scope of section 4A which expressly applies to "*any* entity" – not just natural gas companies – that "directly *or indirectly*" take certain actions in connection with the "*purchase* or sale" of jurisdictional services. In this case, the Commission's construction of its jurisdiction under section 4A does not conflict with section 1(b) because that section does not exempt financial market participants, such as Amaranth, or trading in natural gas futures markets. Furthermore, the logic, if not the result, of the *Conoco* decision can be read to support the Commission's view here that when non-jurisdictional transactions, such as natural gas futures contracts, affect jurisdictional markets, the "in connection with" requirement of section 4(a) would be met.[65] We find no relevance to the few cases cited by Amaranth[66] in which the courts have rejected jurisdictional assertions by the Commission in other contexts that are not present here, other than for the general proposition that the

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[63] *See Northern Natural Gas Co. v. FERC*, 929 F.2d 1261, 1272 (8th Cir. 1991) (discussing the scope of the Supreme Court's decision in *Federal Power Comm'n v. Panhandle Eastern Pipe Line Co.*).

[64] *Williams*, 373 F.3d at 1342-43.

[65] The court in *Conoco* held that when exempt gathering facilities become "intertwined with jurisdictional activities, the Commission's regulation of the latter may inpinge on the former." 90 F.3d at 549. Thus, "[a]s an abstract matter, [the court had] no reason to doubt the Commission's conclusion that a nonjurisdictional entity could act in a manner that would change its status by enabling an affiliated interstate pipeline to manipulate access and costs of gathering." *Id.* The holding in *Conoco* simply rested on the section 1(b) exemption which trumped the section 4(a) language, a construct not relevant here.

[66] Rehearing Request at 36-39.

Commission cannot create jurisdiction that Congress has not conferred.[67]

29. Amaranth's proposed reading is also problematic because it essentially eliminates much of the intended effect of the new section 4A that was hard fought for and prevailed in Congress. Prior to 2005, the Commission had authority under section 4(a) to punish manipulation by sellers in physical natural gas markets and, therefore, had promulgated "Market Behavior Rules" prohibiting manipulation by such sellers.[68] Congress is not presumed to enact surplusage.[69] The better interpretation is that Congress meant to expand Commission authority beyond what existed in 2005 to proscribe the conduct alleged in the OSC. *See* further discussion of the "in connection with" language *infra* at paragraphs 34-45 and 59.

3. Whether the Anti-Manipulation Rule is Limited to "Physical Sellers" or "Sales" Transactions.

30. Amaranth's next specific argument is that the Commission is "bootstrapping"[70] language in the NGA's new section 4A into a new and broad jurisdictional grant that reaches beyond physical sellers and their sales transactions. This argument is without merit because it ignores the simple fact that new section 4A was, indeed, a new and broad

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[67] Amaranth's reliance on *Altamont Gas Transmission Co. v. FERC*, 92 F.3d 1239 (D.C. Cir. 1996), *Bonneville Power Admin. v. FERC*, 422 F.3d 908 (9th Cir. 2005), *pet. for cert. pending,* No. 07-155 (filed Aug. 6, 2007); *California Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004), and *N. States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999) is misplaced. In each of these decisions, the courts concluded that the plain language of the statute clearly delineated FERC's jurisdiction. *Altamont,* 92 F.3d 1239 (NGA expressly reserved to states the authority to determine the intrastate rate structures); *Bonneville,* 422 F.3d 908 at 917-19 (FPA expressly states that FERC's jurisdiction extends to public utilities and that FERC's refund authority does not extend to governmental entities); *California Indep. Sys. Operator*, 372 F.3d at 401 (FPA limited FERC's authority over public utility boards); and *N. States Power Co.*, 176 F.3d at 1095 (federal regulation extends to matters not subject to state regulation and states have authority over retail rates and practices). In this case, the NGA expressly confers jurisdiction upon FERC to prohibit market manipulation that is "in connection with" its jurisdictional markets. No other NGA provisions limit FERC's authority to prevent market manipulation.

[68] *See* 18 C.F.R. § 284.403(a) (2005).

[69] *City of Roseville v. Norton*, 348 F.3d 1020, 1028 (D.C. Cir. 2003) (*citing Babbitt v. Sweet Home Chapter of Cmty. for a Great Oregon*, 515 U.S. 687. 698 (1995)).

[70] Rehearing Request at 36.

jurisdictional grant by Congress to the Commission that goes beyond prior Commission jurisdiction to prohibit manipulation involving entities and transactions traditionally not regulated by the Commission.

31. As Amaranth concedes, Congress granted the Commission broad authority to police market manipulation by "*any* entity." The word "any" gives the word it modifies (in this case, "entity") an expansive meaning.[71] Thus, Amaranth's argument that the Commission has authority to assess civil penalties for manipulation only against a physical seller of natural gas is inconsistent with the language of the statute.[72] First, section 4A and the Anti-Manipulation Rule prohibits any entity from "directly or indirectly" engaging in manipulation "in connection with" a jurisdictional transaction. Neither speaks in terms of conduct by an entity "engaged in" or "a party to" such transaction. Contrary to Amaranth's sweeping assertion that the physical and financial markets are "completely separate,"[73] the manipulation alleged here had a profound cross-market effect: on the futures contracts that went to physical delivery, on physical basis transactions, and on transactions based off indices calculated using physical basis transactions. "Increasingly, the price of natural gas in many supply contracts between suppliers and local distribution companies ("LDC") . . . . is determined based upon monthly price indexes closely tied to the monthly settlement of the NYMEX futures contract . . . without question a participant's trading conduct in one venue can effect, and has affected, the price of natural gas contracts in the other."[74] Second, Amaranth's contention that section 23 of the NGA, which directs the Commission to promulgate rules that facilitate price transparency in natural gas markets, confirms that the Commission has civil penalty authority only against "sellers" of natural gas is based on a misreading of the statute. Section 23, which is separate and distinct from section 4A, allows the Commission to obtain information about the price and availability of natural gas from

[71] *Norfolk S. Rwy. Co. v. Kirby*, 543 U.S. 14, 31-32 (2004) (the word "any" gives the word it modifies an expansive reading); *Dep't of Hous. and Urban Dev. v. Rucker*, 535 U.S. 125, 130-31 (2002); *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (one must give effect to each word in a statute so that none is rendered superfluous); *United States v. Gonzales*, 520 U.S. 1, 5 (1997) ("any" is an expansive term, meaning "one or some indiscriminately of whatever kind,"); *New York v. EPA*, 443 F.3d 880, 885-87 (D.C. Cir. 2006) (the word "any" is broadly construed to reflect Congress' intent that all types of physical changes are subject to the Clean Air Act's New Source Review program).

[72] Rehearing Request at 20.

[73] *Id.* at 26.

[74] Testimony of Laura Campbell, Assistant Manager of Energy Resources, Memphis Light, Gas & Water on behalf of APGA before the CFTC (Sept. 18, 2007).

"any market participant," not simply sellers.[75] Section 23(e) specifies that civil penalties for violating *this section* are limited to the three years before notice of the proposed penalty, except in cases where a seller engaged in fraudulent or manipulative activities in violation of section 4A that materially affected the sales contract.[76] This exception to a limitation on a subset of NGA violations implicated by section 23 does not override the broader language of section 4A.[77] In contrast, NGA section 22(a) specifies the Commission's civil penalty authority for violations of *the Act*, which includes violations of section 4A.[78]

32. Consistent with the foregoing authorities, Order No. 670 provides that the statutory phrase "any entity" (which is repeated in the Rule) covers not only companies that have traditionally been subject to the Commission's jurisdiction (such as natural gas pipeline companies or public utilities), but also any company or firm, and natural persons[79] who, "intended to affect, or have acted recklessly to affect, a jurisdictional transaction."[80] Amaranth's contention that only direct purchasers or sellers of physical natural gas are subject to the Commission's anti-manipulation jurisdiction not only is contradicted by the "any entity" language of section 4A, but is directly contradicted by the Supreme Court decision on which it relies. In *United States v. O'Hagan*, the Supreme Court stated that "as written, [section 10(b)] does not confine its coverage to deception of a purchaser or seller of securities; rather the statute reaches *any* deceptive device used "in connection with" the purchase or sale of a security." (citation omitted) (emphasis added).[81] Other cases decided under the Securities Exchange Act generally demonstrate that one can violate Rule 10b-5 (which implements section 10(b)) without being a purchaser or seller of a security.[82]

33. Moreover, section 4A expressly prohibits any entity from "directly or *indirectly*"

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[75] 15 U.S.C. § 717t-2(a)(3)(A).

[76] *Id.* at §§ 717t-2(e)(1) and (2).

[77] *Id.*

[78] *Id.* at §§ 717t-1.

[79] Order No. 670 at PP 2, 18.

[80] *Id.* at P 22.

[81] *O'Hagan*, 521 U.S. 642, 658 (1997).

[82] *See, e.g.*, *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (permitting shareholder suit for damages under Rule 10b-5 where company made misleading statements that affected its own stock).

using a manipulative or deceptive device. The term "indirectly" supports the conclusion that Congress intended the NGA's anti-manipulation prohibition to apply to more than conduct *within* the Commission's traditionally regulated market and more than just the direct wholesale seller of the physical commodity. Amaranth's statutory interpretation effectively reads the term "indirectly" out of the statute, thereby violating the basic rule of statutory construction to give meaning to all statutory terms.[83]

4. The "In Connection With" Requirement

34. Amaranth contends most fundamentally that the Commission lacks jurisdiction over trades outside the physical natural gas markets because of the "in connection with" requirement in NGA section 4A.[84] We find that Amaranth reads the requirement too narrowly and in a manner that precludes the achievement of much of what Congress intended. Congress could have, but did not, prohibit manipulative or deceptive conduct that occurred *in* Commission-jurisdictional markets. Instead, Congress used expansive language that prohibits manipulative or deceptive practices by any entity, directly or indirectly, "in connection with" the purchase, sale or transportation of natural gas historically within the Commission's jurisdiction. We discussed this phrase in the OSC[85] and we revisit it more fully here.

35. Because the clause "in connection with" is undefined, we begin with an examination of ordinary usage.[86] According to Fowler's Modern English Usage, "in connection with" is noted for . . . its "pliability."[87] Furthermore, "connection" is defined by Webster's Third New International Dictionary 481 (1981) as a "relationship or association in thought (as of cause and effect, logical sequence, mutual dependence or involvement."[88] Therefore, in a variety of contexts, courts have broadly and flexibly

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[83] *TRW Inc.*, 534 U.S. at 31 (each word in a statute must be given meaning).

[84] Rehearing Request at 26-39.

[85] OSC at PP 50, 110.

[86] *Engine Mfrs. Ass'n v. South Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 253 (2004) (statutory construction begins with the plain language of the statute and the assumption that the ordinary meaning of the language reflects the statutory purpose); *Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (interpret undefined statutory terms by referring to the term's ordinary usage).

[87] Fowler's Modern English Usage 172 (R.W. Burchfield ed., 3d ed. 1996).

[88] *See also* American Heritage Dictionary of the English Language 400 (3d ed. 1992) (connection is an association or relationship).

interpreted the phrase "in connection with" to encompass a wide variety of relationships and always with an eye to accomplishing statutes' broad remedial purposes.[89]

36. In addition to considering the common definition of language used in the statute, we also evaluate (as we did in Order No. 670) how "in connection with" is used in section 10(b) of the Securities Exchange Act, on which section 4A was modeled.[90] Cases construing section 10(b) and Rule 10b-5, as well as legislative history of section 10(b), are therefore relevant to the Commission's construction of section 4A. In its Rehearing Request, Amaranth claims that only the phrase "manipulative scheme or device" (and not the rest of NGA section 4A) are to be construed consistent with section 10(b).[91] While section 4A states that the phrase is to be so construed, a comparison of identical phrases used throughout section 4A and section 10(b) shows that Congress intended section 4A and the implementing rules to be modeled after section 10(b).

37. The "in connection with" language of section 10(b) has been construed expansively by the Supreme Court to accomplish the broad remedial purposes of section 10(b) which was enacted to restore the integrity of securities markets and promote investor confidence following the stock market crash of 1929.[92] In *Zandford* and *Bankers Life & Cas. Co.*, the Supreme Court upheld the SEC's broad and flexible reading of the "in connection with" requirement of section 10(b) to accomplish the broad

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[89] *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (*Zandford*) ("in connection with" should be read broadly and flexibly, not restrictively); *Superintendent of Ins. of New York v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10 (1971); *United States v. Wyatt*, 102 F.3d 241, 247 (7th Cir. 1996) ("in connection with" is interpreted expansively); *United States v. Thompson*, 32 F.3d 1, 6-7 (1st Cir. 1994) (same); *SEC v. Hopper*, No. 04-1054, 2006 U.S. Dist. LEXIS 17772 (S.D. Tex. Mar. 24, 2006) ("[a] plaintiff makes out a sufficient nexus with the purchase or sale of securities when the defendants' deceptive conduct affects a market for securities.") (*quoting In re Parmalat Sec. Lit.*, 376 F. Supp. 2d 472, 505-06 (S.D.N.Y. 2005)).

[90] 15 U.S.C. § 717c (2005) (terms are used in the same manner as section 10(b)).

[91] Rehearing Request at 31-32.

[92] *See Zandford*, 535 U.S. at 819 (the "in connection with requirement" of the SEC regulatory scheme, on which the Anti-Manipulation Rule is modeled, should be interpreted flexibly, not technically and restrictively, to accomplish the statutes' remedial purposes of promoting market integrity and investor confidence) (*citing United States v. O'Hagan*, 521 U.S. 642, 651 (1997)); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 78 (2006) ("the magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated"); *Bankers Life & Cas. Co.*, 404 U.S. at 10 (construction of section 10(b) extends beyond maintaining the integrity of securities markets).

remedial purpose of the statute. Here we note the historical similarity of the posture of the Securities and Exchange Commission (SEC) in 1934 to our own situation with respect to the anti-manipulation provisions. In response to the Western energy crisis of 2000-2001, EPAct 2005's parallel anti-manipulation provisions were added to both the FPA and NGA to ensure that the Commission had sufficient tools to address and punish manipulative behavior such as that engaged in by Enron during the crisis. Congress clearly did not want to limit the types of manipulation that might harm jurisdictional markets and thus provided broad, general language to allow the Commission to sanction unforeseen types of manipulation that could harm customers. As the SEC broadly construed the Securities Exchange Act in early enforcement actions to restore confidence in financial markets, we will similarly broadly construe the "in connection with" provision to effectuate the Congressional purpose of the anti-manipulation provisions enacted as part of EPAct 2005.

38. In *Zandford*, the Supreme Court held that the "in connection with" requirement was met when deceptive acts, such as the misappropriation of proceeds from the purchase or sale of securities, coincided with the purchase or sale of securities, even though the transactions themselves are lawful.[93] Similarly, *SEC v. Hopper* held that even though "round-trip" trading (which involves pre-arranged sham transactions designed to artificially increase trading volumes) may not have involved directly the purchase or sale of a security, "a plaintiff makes out a sufficient nexus with the purchase or sale of securities when the defendant's deceptive conduct affects a market for securities."[94] Thus, the court held that the alleged fraud which arose from statements about transactions, and not the transactions themselves, may satisfy the "in connection with" requirement if investors considered the energy company's false trading numbers in deciding whether to purchase or sell the company's securities.[95] Indeed, the entire line of

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[93] *Zandford*, 535 U.S. at 819-20 (even though the stockbroker's actual sale of securities was lawful, section 10(b) extends to the stockbroker's scheme to defraud his clients). *See also Bankers Life & Cas. Co*., 404 U.S. at 12-13 (the "in connection with" requirement is met when the deceptive act of misrepresenting who would receive the proceeds from the sale of bonds "touches" the purchase or sale of a security). *See also Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 596 (2001) (although a formal transaction in the securities market did not take place, section 10(b) applied to an oral contract for the sale of an option on a security, while the seller secretly intended to never allow the purchaser to exercise the option.).

[94] *SEC v. Hopper*, No. 04-1054, 2006 U.S. Dist LEXIS 17772 at *39 (S.D. Tex. Mar. 24, 2006) (*quoting In re Parmalat Sec. Lit.*, 376 F. Supp. 2d 472, 505-06 (S.D.N.Y. 2005)).

[95] *Hopper* at *40-41.

section 10(b) "insider trading" cases where a "tipper" does not herself trade in securities but only the outsider "tippee" does so, are predicated on the notion that the section 10(b) violation need not be directly tied (either contractually or temporally) to the securities trading.[96]

39. In its most recent pronouncement on the "in connection with" requirement, the Supreme Court again reaffirmed the breadth of the phrase. "[W]hen this Court *has* sought to give meaning to the phrase ["in connection with"] in the context of section 10(b) and Rule 10b-5, it has espoused a broad interpretation."[97] Importantly, the Court in *Shadi* also affirmed that this breadth is imported into other statutes where, as with NGA section 4A, Congress replicates section 10(b) language in those other statutes.[98] "Congress can hardly have been unaware of the broad construction adopted by both [the Supreme Court] and the SEC when it imported the key phrase - - 'in connection with the purchase or sale' into" other statutes.[99]

40. Congress' intention to cover a wide range of conduct is further evidenced in the broad remedial purpose and legislative history of section 10(b), wherein the Congressional committee reporting on what became section 10(b) noted that deceptive practices "constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers" in the regulatory agency "have been found practically essential."[100] Similarly, as noted above, the 109th Congress favored the broad prohibitory language we have in the statute today.

41. Amaranth states that in the vast majority of securities cases, the conduct may directly involve the purchaser of a security.[101] But this, even if true, is because the SEC

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[96] *E.g. SEC v. Rocklage*, 470 F.3d 1, 8-10 (1st Cir. 2006) (spouse of insider who passed on inside information to a third person, but did not herself trade securities, satisfied the "in connection with" requirement and was found to violate securities trading laws within the meaning of *Zandford* because she knew that the likely result of her tip would be to affect securities trading).

[97] *Merrill, Lynch, Pierce, Fenner & Smith Inc. v. Shadi*, 547 U.S. 71, 85 (2006).

[98] *Id.* at 85-86.

[99] *Id.* at 85 (the court broadly construed the "in connection with" requirement contained in the Securities Litigation Uniform Standards Act of 1998).

[100] *Bankers Life & Cas. Co.*, 404 U.S. at 12 (*quoting* H.R. Rep. No. 1383, 73d Cong. 2d Sess. 7).

[101] Rehearing Request at 32.

would ordinarily seek to punish fraud that is perpetrated against a specific investor by an offeror or seller. In such cases, the sale of a security will be present. The frequency of this fact pattern, however, does not amount to a legal requirement. Where, as here, the Commission is responsible for protecting wholesale markets and the customers that rely on those markets, we believe it is reasonable to interpret section 4A in a way that does not permit market manipulation abuses that, as here, have a direct link to jurisdictional prices of gas, to go unremedied by the Commission.

42. There are multiple decisions holding that the "in connection with" requirement is met under fact patterns similar to those presented in the OSC. The Supreme Court defined market manipulation under Rule 10b-5 as conduct "*controlling or artificially affecting* the price of securities"[102] or practices that "artificially affect market activity."[103] Courts have sustained Rule 10b-5 claims when misrepresentations and omissions are made regarding Treasury bill futures contracts (even though futures contracts are not "securities") because the asset *underlying* the futures contract (a Treasury bill) is a security.[104] Similarly, in this case, the Commission preliminarily concluded in the OSC that Amaranth's trading in NG Futures Contracts actually set the NG Futures settlement price, which is directly incorporated into the pricing of physical natural gas within the Commission's jurisdiction. Given the connections between the trading behavior at issue and physical natural gas markets, a finding that the "in connection with" requirement is met is appropriate.

43. The cases cited by Amaranth to support its narrow construction of the "in connection with" requirement are inapposite.[105] First, *Ontario Pub. Serv. Employees v. Nortel Networks Corp.* is a *standing* case which concludes that one who is not actually injured by securities-related conduct cannot bring a private right of action.[106] Because the court found "that the plaintiffs lack standing under section 10(b), [the court did] not

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[102] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976) (emphasis added).

[103] *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977).

[104] *Paine Webber, Jackson & Curtis, Inc. v. Conaway*, 515 F. Supp. 202, 210 (N.D. Ala. 1981). *See also Fisher v. Dean Witter Reynolds, Inc.* 526 F. Supp. 558, 560 (E.D. Pa. 1981) (fraud in the sale of treasury bills futures contracts violates SEC Rule 10b-5).

[105] *See* Rehearing Request at 33.

[106] *Ontario Pub. Serv. Employees v. Nortel Networks Corp.*, 369 F.3d 27, 33 (2d Cir. 2004) (*Ontario*).

reach the 'in connection with' requirement.".[107] Second, *Rand v. Anaconda-Ericsson, Inc.*[108] (*Rand*) did not hold, as Amaranth contends, that the fraudulent conduct must be *in* a securities transaction. Instead, the court held that a press release declaring a company in default under a security agreement does not violate Rule 10b-5's anti-fraud provision because the prohibited conduct did not have "incidental involvement of securities."[109] The *Rand* court also noted that "misrepresentations about the financial condition of a broker-dealer were 'in connection with' a securities transaction where the broker-dealer's financial strength was directly related to its ability to carry out obligations under agreements calling for the repurchase or resale of government securities. The misrepresentations went to the consideration for a securities transaction."[110] Thus, the *Rand* court clearly acknowledged that the purchase or sale of securities in the securities market is not a pre-requisite to SEC jurisdiction.

44. Amaranth reads the securities cases, particularly *Zandford*, as permitting the "in connection with" test to be satisfied only where the manipulation "coincided with the sales themselves."[111] We do not read the cited language of *Zandford* as the complete expression of the test, but were it so, the test would certainly be satisfied on the facts of this case.[112] The OSC alleges that Amaranth traded between 2:00 and 2:30 PM on each of the three settlement days with the specific intent and actual effect of artificially setting the price of the NG Futures Contracts. Further, the OSC alleges that within an instant of that trading, effectively at 2:31 PM, and as a direct result of that trading, the settlement price became the price for the above-identified physical sales at Henry Hub. It is difficult

[107] *Id.* This decision did not address whether a regulator could enforce a prohibition on the identified conduct.

[108] 794 F.2d 843, 847 (2d Cir. 1986).

[109] *Id.*

[110] *Id.* (*citing* in *SEC v. Drysdale Sec. Corp.*, 785 F.2d 38 (2d Cir. 1986)).

[111] Rehearing Request at 32 (*citing Zandford*, 535 U.S. at 820).

[112] Although the *Zandford* court certainly determined that the securities transactions "coincide"[d] with the wrongful conduct and "therefore were in connection with" securities sales within the meaning of §10(b)," *Zandford* at 822, we do not read the opinion as holding that this "coincidence" is the only way to meet the "in connection with" requirement. We read *Zandford* as supporting the view that "[t]he precise contours of the in connection with requirement are not self-evident. It seems unavoidable 'that the standard be fleshed out by a cautious case-by-case approach.'" *Chem. Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 942-43 (2d Cir. 1984).

to imagine how much more "coincidence" there could be between Amaranth's trading and Commission jurisdictional sales.

45. Finally, post-enactment oversight inquiries from Congress support the Commission's determination regarding its anti-manipulation jurisdiction. Senator Bingaman, who was Ranking Member on the Senate Committee on Energy and Natural Resources when EPAct 2005 was enacted, noted in a letter to the Commission that "the evolution of complex and interrelated markets for financial and physical energy commodities has elevated the importance of the Federal Energy Regulatory Commission's . . . role."[113] The Senator also inquired into "efforts [by the Commission] to monitor *trading of NYMEX gas futures contracts*, especially as it relates to end-of-month natural gas trading."[114] Similarly, the Government Accountability Office (GAO) noted that EPAct 2005 gave the Commission authority to "examine whether financial market transactions, which are not generally under the Commission's jurisdiction, affect the physical natural gas markets over which FERC has authority" and enforce it against any entity, if the manipulative trading, whether intentionally or recklessly, affects physical natural gas markets.[115] These views are consistent with the Commission's interpretation that section NGA section 4A properly applies to "producers, financial companies, local utilities, and natural gas traders, most of which were not previously regulated by FERC," that engage in manipulative conduct that affect the Commission's jurisdictional markets.[116]

B. The Commission's Anti-Manipulation Authority As Compared to the CFTC's Jurisdiction

46. Amaranth's central contention is that manipulation of natural gas markets of the type alleged by the Commission in the OSC is within the CFTC's "exclusive" jurisdiction and, therefore, even if the alleged conduct is covered by the NGA, the Commission is pre-empted from taking action.[117] Explicit in Amaranth's jurisdictional argument is the underlying notion that the financial and physical natural gas markets are "completely

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[113] *See* Letter from Senator Bingaman, Chairman, Committee on Energy and Natural Resources, to Joseph Kelliher, Chairman, FERC (Feb. 6, 2007).

[114] *See Id. a*t 2 (emphasis added).

[115] U.S. GOV'T. ACCOUNTABILITY OFFICE, ROLES OF FEDERAL AND STATE REGULATORS IN OVERSEEING PRICES at 16.

[116] *Id.* at 15. *See also* Order No. 670 at PP 2, 18, and 22.

[117] Rehearing Request at 12-16.

separate" markets (*see, e.g.* Amaranth CFTC Brief at 15), and that the CFTC is the only agency to police the financial markets, while the Commission may police only the physical natural gas market.[118] We address each argument below.

1. CFTC's Exclusive and Non-Exclusive Jurisdiction

47. Amaranth contends that section 2(a)(1)(A) of the CEA conclusively establishes that the CFTC has exclusive jurisdiction over Amaranth's conduct.[119] The CEA provides that "[t]he Commission [CFTC] shall have exclusive jurisdiction . . . with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery."[120] This Commission indisputably recognizes that the CFTC has exclusive jurisdiction over transactions involving contracts of sale of a commodity for future delivery, *i.e.*, futures transactions, just as this Commission has exclusive jurisdiction over rates, terms and conditions of jurisdictional sales of resale of natural gas in interstate commerce, *i.e.*, physical transactions. The fact that the CFTC has exclusive jurisdiction over these activities does not mean that it has exclusive jurisdiction over fraudulent or deceptive practices associated with those transactions, or that other agencies such as this Commission are precluded from examining fraudulent or deceptive conduct in exercising their regulatory responsibilities, particularly where this Commission has been provided express authority with respect to such conduct if it has a nexus to jurisdictional physical sales.[121] For the reasons discussed below, we do not believe it is reasonable to interpret section 2(a)(1)(A) of the CEA, when read in conjunction with other provisions of law, to give the CFTC exclusive jurisdiction over manipulative conduct involving futures transactions.

48. A line of court decisions under the CEA, known as the "exempt commodities cases," support the position that the CFTC does not have exclusive jurisdiction as to manipulation. The CEA provides that "agreements, contracts, and transactions" in "exempt" commodities, such as natural gas, are beyond the CFTC's jurisdiction.[122]

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[118] *Id.* at 13-16.

[119] *Id.* at 22.

[120] 7 U.S.C. § 2(a)(1)(A) (2006).

[121] *See FTC v. Roberts*, 276 F.3d 583, 591 (D.C. Cir. 2001) ("it does not follow from this, however, that Congress intended to preempt the activities of all other federal agencies in their regulatory realms.").

[122] *See* 7 U.S.C. §§ 2(a) (exclusive jurisdiction provision), 2(g) and 2(h) (exemptions from § 2(a)) (2000).

However, to assert jurisdiction over false reporting, manipulation, and other fraudulent and deceptive conduct in exempt commodities, the CFTC successfully argued that manipulation and deceptive conduct, by their very nature, do not involve a "mutual understanding" creating enforceable rights or obligations with counterparties and, therefore, such conduct is not a "contract, agreement or transaction," but merely conduct *related to* a "contract, agreement or transaction" in a commodity.[123] In *CFTC v. Bradley,*[124] the CFTC argued it had jurisdiction under the CEA to punish the manipulative conduct of knowingly providing false and misleading information concerning natural gas transactions. The CFTC argued that such manipulative conduct is not a "contract, agreement, or transaction," because those terms, "as commonly understood, denote[] a mutual understanding between the parties creating rights or obligations that are enforceable or recognized by law."[125] The court sustained that argument.

49. Accordingly, these cases stand for the general proposition that in interpreting the exclusive and non-exclusive jurisdiction under the CEA, manipulation does not involve a mutual understanding or meeting of the minds necessary to consummate an "account, agreement, or transaction," or a "contract, agreement, or transaction" as those terms are commonly understood and, therefore, manipulation is neither excluded from CFTC's jurisdiction over otherwise "exempt commodities" nor is it within the CFTC's *exclusive* jurisdiction. Although most of these cases involved manipulation of markets caused by

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[123] *Roberts*, 276 F.3d at 591. *See also CFTC v. Reed*, 481 F. Supp. 2d 1190 (D. Colo. 2007); *U.S. v. Valencia*, No. 03-024, 2003 U.S. Dist. LEXIS 15264 (S.D. Tex. Aug. 25, 2003); and *CFTC v. Atha*, 420 F. Supp. 2d 1373 (N.D. Ga. 2006). These cases involved interpretation of a parallel provision of the CEA that uses the terms "contract, agreement, or transaction." Given the parallel language and same broad remedial purpose, the interpretation should be the same.

[124] 408 F. Supp. 2d 1214 (N.D. Okla. 2005).

[125] *Id*. at 1219 (*quoting* Black's Law Dictionary 318 (7th Ed. 1999)). In *CFTC v. Reed*, 481 F. Supp. 2d 1190 (D. Colo. 2007), the CFTC successfully argued that "false reporting of market information concerning natural gas and attempted manipulation of natural gas price indices [] does not implicate an 'agreement, contract, or transaction.'" *Id.* at 1198 (*quoting U.S. v. Valencia*, No. 03-024, 2003 U.S. Dist. LEXIS 15264 at * 36 (S.D. Tex. Aug. 25, 2003)). *See also CFTC v. Atha*, 420 F. Supp. 2d 1373 (N.D. Ga. 2006) (false price reporting is not an account, agreement or transaction). Most recently, the court in *CFTC v. Johnson*, 408 F. Supp. 2d 259 (S.D. Tex. 2005) held that false reporting of natural gas transactions is not an "account, agreement, or transaction" and, therefore, the CFTC had jurisdiction over attempted manipulation of natural gas prices.

false reporting of information (a fact not present here), the CFTC recently filed a case against Energy Transfer Partners (ETP), alleging attempted manipulation that did not involve false reporting.[126] In *ETP*, the CFTC maintains that it has jurisdiction over manipulative trading in physical natural gas markets, which are otherwise exempt from the CFTC's jurisdiction, because manipulative conduct is not a "contract, agreement, and transaction." By extension, manipulation is also not within the CFTC's exclusive jurisdiction.

50. The case of *FTC v. Roberts* (*Roberts*) is the most recent and comprehensive review of this subject and makes the distinction between the CFTC's exclusive jurisdiction over "accounts, agreements, and transactions" and its non-exclusive jurisdiction over fraudulent and deceptive practices. *Roberts* explained that "while the CFTC has clear statutory authority to regulate a [trader's] deceitful 'practices' . . . . there is no reason to think the authority is exclusive. A 'practice' or 'course of business' is quite plainly not a 'transaction' – either in life or in this statutory provision. (Nor for that matter is it an 'account' or 'agreement.')."[127] The D.C. Circuit held in *Roberts* that the notion that whatever the CFTC regulates it does so exclusively is a "specious contention." [128] Thus, the case law supports the interpretation that the exclusive jurisdiction provision cited by Amaranth does not apply to Amaranth's alleged manipulative conduct[129] and, the CEA language notwithstanding, "other agencies . . . retain their jurisdiction beyond the confines of 'accounts, agreements, and transaction'"

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[126] As with this matter, the Commission's staff coordinated its lengthy investigation with a parallel investigation by the CFTC staff into alleged market manipulation of physical natural gas by ETP. Those investigations, as here, resulted in simultaneous enforcement actions by the two agencies, including the CFTC asserting its jurisdiction in a complaint filed in the United States District Court for the Northern District of Texas. *CFTC v. Energy Transfer Partners, L.P.*, Civil Action No. 3-07-Cv. 1301 (N.D. Texas). The Commission's Order to Show Cause issued to *ETP* in IN06-3-002.

[127] 276 F.3d at 591.

[128] *Id.*

[129] *See also SEC v. Hopper*, No, 04-1054, 2006 U.S. Dist. LEXIS 17772 at *37-42 (S.D. Tex. Mar. 24, 2006) (because energy trading transactions were fraudulent and deceptive within the meaning of Rule 10b-5, the SEC could proceed at the same time as the Commission and the CFTC); *U.S. v. Reliant Energy Serv.*, 420 F. Supp. 2d 1043, 1045 (N.D. Cal. 2006) (the Commission's exclusive jurisdiction under the FPA to regulate the transmission and sale at wholesale of electricity in interstate commerce did not preempt the anti-manipulation jurisdiction under the CEA pertaining to electricity prices during the Western energy crisis).

for futures contracts.[130]

51. The majority of cases cited by Amaranth in support of the claim that the CFTC has exclusive jurisdiction in this case address the narrow question of whether CFTC or the SEC has enforcement jurisdiction *in the first instance* over certain market segments and products. [131] None of these cases address whether the particular manipulative activity was subject to the jurisdiction of both agencies or whether the manipulation was "in connection with" the SEC's jurisdictional markets, *i.e.*, whether the conduct might fall within both agencies' non-exclusive jurisdiction. Indeed, in *Chicago Merc. Exch. v. SEC,* the court expressly stated it was not deciding the related question of whether the SEC has authority to apply its anti-fraud rules to commodity options transactions.[132] The other cases cited by Amaranth generally resolve broad questions of whether the SEC could set terms or perform other "prospective" oversight or regulation over designated contract markets, a question not present here.[133] In any event, these cases pre-date the 2000 amendments to the CEA, which affirmed the SEC's jurisdiction over fraud claims involving futures.[134]

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[130] *Roberts*, 276 F.3d at 591.

[131] Rehearing Request at 35-36 (*citing Chicago Merc. Exch. v. SEC,* 883 F.2d 537 (7th Cir. 1989), *Chicago Bd. Of Trade v. SEC,* 677 F.2d 1137 (7th Cir. 1982), *SEC v. Am. Commodity Exch.* 546 F.2d 1361 (10th Cir. 1976), and *SEC v. Univest, Inc*., 405 F. Supp. 1057, 1058 (N.D. Ill. 1975)). Each case resolved a dispute over whether a certain financial product was a futures contract or an option on a futures contract subject to the exclusive jurisdiction of the CFTC, or a security or an option on a security subject to SEC regulation.

[132] 883 F.2d 537 (7th Cir. 1989).

[133] *Chicago Bd. of Trade v. SEC,* 677 F.2d 1137 (7th Cir. 1982); *Chicago Merc. Exch. v. SEC,* 883 F.2d 537 (7th Cir. 1989).

[134] In 2000, Congress passed the Commodities Futures Modernization Act (CFMA), which amended and re-authorized portions of the CEA. One purpose of the CFMA, *inter alia*, was to clarify that the CFTC and the SEC would *share* jurisdiction over products that had characteristics of both securities and futures. Because section 10(b) and Rule 10b-5 serve as the model for section 4A and Order No. 670, the legal precedent upholding the SEC's jurisdiction over fraud and manipulation in these "non-securities" transactions that involve a security as the underlying commodity strongly supports the Commission determination that the CEA does not eclipse section 4A.

2. **The CEA "Other Regulatory Authorities" Savings Clause and the Commission's Jurisdiction**

52. Even if the conduct alleged by the Commission in the OSC could be read to fall within the text of the exclusive jurisdiction provision of the CEA, "it does not follow. . . . that Congress intended to preempt the activities of all other federal agencies in their regulatory realms. . . . Preemption of the regulation of the market does not also mean preemption of all law that might involve participants in the market."[135] This is clarified in the "savings clause" contained in the CEA.

53. The CEA savings clause, which immediately follows the exclusive jurisdiction provision, states:

> Except as hereinabove provided, nothing contained in this section shall (I) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or any state, or (II) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws.[136]

54. The purpose of any savings clause is to "preserve something from immediate interference."[137] Contrary to Amaranth's claim, there is no evidence that Congress intended the savings clause to prevent a "regulatory overlap" between the CFTC and the Commission over manipulation of natural gas markets. Instead, "[i]nclusion of the so-called 'regulatory savings clauses,' § 2(a)(1)(A)(I)-(II), makes clear that other agencies . . . retain their jurisdiction beyond the confines of 'accounts, agreements, and transactions involving contracts of sale of a commodity for future delivery."[138] The expansive anti-manipulation authority given to the Commission in NGA section 4A and FPA section 222 was enacted by Congress five years subsequent to the most recent amendments to the CEA, and several years after the Commission uncovered the manipulative practices occurring in both natural gas and electric markets in connection with its investigation of the Western energy crisis of 2000-2001. More to the point, neither section 4A nor section 222 contain a savings clause, suggesting that Congress did

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[135] *Roberts*, 276 F.3d at 591 (*quoting Poplar Grove Planting and Ref. Co. v. Bache Halsey Stuart Inc.*, 465 F. Supp. 585, 592 (D. La. 1979)).

[136] 7 U.S.C. § 2(a)(1)(A) (2006).

[137] *Knickerbocker Ice Co. v. Stewart*, 253 U.S. 149, 162 (1920).

[138] *Roberts*, 276 F.3d at 591(*quoting Chicago Merc. Exch. v. SEC,* 883 F.2d 537, 550 (7th Cir. 1989) (section 2 "carries no implicit pre-emptive force")).

not intend the CEA to trump the broad authority conferred on the Commission to take action against any entity that directly or indirectly employs, in connection with a purchase or sale subject to the jurisdiction of the Commission, a manipulative device. We interpret the CEA's section 2(a) savings clause to simply preserve any and all authority conferred to the Commission by Congress.[139]

55. Amaranth's argument that the CEA permits the Commission to retain jurisdiction only for matters "beyond the confines of accounts, agreements, and transactions involving contracts of sale of a commodity for future delivery"[140] is not in conflict with our own view. The manipulation in this case (as in the CFTC's cases pertaining to manipulation of physical natural gas) is conduct that goes "beyond" the "confines" of "accounts, agreements, and transactions."[141] However, if there is any doubt on this score, we interpret the savings clause, in conjunction with the broad wording of section 4A itself and Congress' reasons for adding the anti-manipulation provisions to the NGA and FPA, to resolve the issue in favor of our jurisdiction.

56. We do not interpret the phrase "except as hereinabove" in the CEA savings clause to transfer any jurisdiction over "accounts, agreements, and transactions" from other agencies to the CFTC. This would render the savings clause superfluous and would exclude other agencies (both federal and state) from taking any action with respect to those activities and there would be no need for a savings clause. The better view, which is consistent with basic rules of statutory construction and legal precedent discussing the purpose of savings clauses, is that the phrase "except as hereinabove provided" means that, unless Congress expressly modified "hereinabove" the jurisdiction of the SEC or other federal agencies, the jurisdiction of the SEC and other federal agencies remains undisturbed.[142]

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[139] Similarly, the savings clause in NGA section 23(c)(2) likewise preserves the jurisdiction conferred by the CEA to the CFTC. That provision does not, as Amaranth contends at page 19 of its Rehearing Request, establish that Congress intended to withhold regulatory power from the Commission.

[140] Rehearing Request at 15.

[141] *Id.* at 15-16.

[142] In fact, Congress did just that in preceding sections where it divided certain areas of responsibility between the CFTC and SEC. *See, e.g.,* 7 U.S.C § 2(a)(1)(D). We recognize that a 1975 decision of a United States District Court, subsequently remanded without opinion, reached a contrary construction of the savings clause. *SEC v. Univest, Inc.*, 405 F. Supp. 1057, 1058 (N.D. Ill 1975). Our review of that opinion discloses virtually no analysis of the issues and we choose instead to follow an analysis which is

3. The Commission's Overall Construction of the Statutes

57. The Commission's jurisdictional determination is in harmony with Congress' more recent expression on these related issues, EPAct 2005, as well as judicial precedent permitting multiple agencies to protect their respective constituents.[143] Indeed, the foregoing analyses are the most reasonable way to harmonize the various provisions and precedents relating to our jurisdiction, the jurisdiction of the CFTC, and cases construing section 10(b) of the Securities Exchange Act, which served as the model for new NGA section 4A and the parallel FPA section 222.[144] It is a basic tenet of statutory construction that when courts are construing different statutes on the same subject matter, they do so in a way that gives effect to each.[145] Amaranth's interpretation undermines the very intent of section 4A to give the Commission ability to sanction manipulation that has a clear nexus to and significant effect on jurisdictional prices.

58. The Commission's determination does not interfere with the CEA's mandate that the CFTC regulate exclusively the day-to-day aspects of futures trading (albeit not manipulation), such as the terms or conditions of sale of NG Futures contracts, the operating rules of the NYMEX exchange, or traders' commodity accounts. The CFTC focuses its efforts on regulating instruments related to sixty-seven products and making

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more consistent with overall statutory scheme before us and the much more recent and thorough analysis of the D.C. Circuit in *Roberts* as noted above.

[143] *See FTC v. Cement Inst.*, 333 U.S. 683, 694 (1948) (two or more agencies may proceed simultaneously against the same parties and the same conduct); *Bristol-Meyers Co. v. FTC*, 738 F.2d 554, 559-60 (2d Cir. 1984) (concurrent Federal Trade Commission/Food and Drug Administration jurisdiction approved); *Warner-Lambert Co. v. FTC,* 361 F. Supp. 948, 952-53 (D.D.C. 1973) (court upheld concurrent enforcement action by the FDA and FTC, even though they involved the same parties or issues, because the statutory remedies of the two agencies are cumulative and not mutually exclusive). *See also U.S. v. Reliant Energy Serv.*, 420 F. Supp. 2d 1043, 1064 (N.D. Cal. 2006) (where two federal laws cover the same conduct, both may be applied because "congressional intent behind one federal statute should not be thwarted by the application of another federal statute").

[144] It is a fundamental canon of statutory construction that statutes relating to the same subject matter should be construed harmoniously and, if not, the more recent or specific statute should prevail over the older and more general law. *Tug Allie-B. v. U.S.*, 273 F.3d 936, 941 (11th Cir. 2001).

[145] *United States v. Borden Co.,* 308 U.S. 188, 191 (1939) (where two statutes address the same subject, the "rule is to give effect to both if possible").

sure that "designated contract markets," such as the NYMEX, operate properly. The CFTC is not focused on the underlying or downstream markets. The Commission respects these exclusive regulatory functions and the CFTC's expertise and exclusive regulatory authority with respect to operation of the futures markets for dozens of commodities. The Commission does not seek to police the NYMEX or other exchanges, nor does the Commission seek to prevent Amaranth from trading on futures markets. Instead, the Commission is exclusively concerned with protecting the integrity and competitiveness of energy markets. When manipulation of NG Futures Contracts spans both financial and energy markets, the Commission has authority to investigate and, if appropriate, punish that manipulation that affects its jurisdictional markets. Congress recognized through EPAct 2005 that both agencies have an enforcement role to protect their respective markets and interests. We pursued this role in the present case and the CFTC has taken similar action in its manipulation case against ETP. There, the CFTC alleged that ETP manipulated futures markets subject to its jurisdiction, even though the alleged misconduct occurred in physical natural gas markets that are subject to our exclusive jurisdiction, not that of the CFTC. There, as here, each agency has merely sought to police manipulation that substantially impairs the competitiveness of the markets it regulates.

59. The legislative history of EPAct 2005 confirms that Congress expanded the Commission's jurisdiction, while the CFTC's day-to-day market oversight program was already well known.[146] In fact, a few Senators expressed concern that the Cantwell Amendment would lead to "unnecessary duplication" of effort by enforcement agencies such as the SEC and the CFTC.[147] Congress nevertheless "put in place the first ever broad prohibition on manipulation in electricity and natural gas markets."[148] Congress knew that it was placing an additional cop on the beat alongside the CFTC and the SEC

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[146] 149 Cong. Rec. S 13997 at 9 (daily ed. Nov. 5, 2005) (statement of Sen. Bennett) (Both the CFTC and the SEC have broad authority to prohibit market manipulation); 151 Cong. Rec. S 7451 at 40 (daily ed. June 28, 2005) (statement of Sen. Cantwell) (the Cantwell Amendment, which was eventually incorporated into EPAct 2005, gave FERC the tools to prevent abuses in energy markets). *See also* 151 Cong. Rec. S 9335 at 16-17 (daily ed. June 29, 2005) (statement of Sen. Cantwell) ("This Energy bill puts in place the first ever broad prohibition on manipulation of electricity and natural gas markets" and is modeled on a measure authored by Senator Cantwell and passed twice in the Senate).

[147] *See* 149 Cong. Rec. S 13997 at 9 (daily ed. Nov. 5, 2005) (statement of Sen. Bennett).

[148] 151 Cong. Rec. S 9335 at 17 (daily ed. July 29, 2005) (statement of Sen. Cantwell).

by giving FERC additional tools to ensure that manipulative and deceptive practices do not occur in energy markets. Thus, Congress expected to hold "FERC [not just the CFTC] accountable if, in fact, manipulative or deceptive practices occur in the future."[149]

60. The legislative history of EPAct 2005 also confirms that Congress expressly rejected a proposal to state that the CFTC's exclusive jurisdiction was not trumped by the NGA. The House Energy and Commerce Committee Report on HR 6 contained a completely new provision to be added to the NGA, known as "section 26," which provided that *nothing* in the NGA shall affect the "exclusive jurisdiction of the [CFTC] with respect to 'accounts, agreements, or transactions in commodities under the CEA.'"[150] However, that provision was rejected, as it does not appear in the final bill. Instead, Congress included only a narrower savings clause in section 23 (Natural Gas Market Transparency Rules), which provides that nothing in that section (pertaining to gathering information from market participants) can be construed to limit the CFTC's exclusive jurisdiction. Nowhere in the EPAct 2005 amendments, whether a savings clause or elsewhere, did Congress indicate any intent to give only the CFTC authority over manipulative practices. Having considered the matter, had Congress intended to confer upon the CFTC exclusive jurisdiction over manipulation occurring in natural gas futures markets, it could have done so explicitly in the NGA section 4A and FPA section 222 sections, incorporated "section 26" into the NGA as a whole, or, at a minimum, included the savings clause in the NGA's Anti-Manipulation provision, section 4A. Instead, section 4A makes no mention of the CFTC's jurisdiction nor does it contain a savings clause, which is included in the more narrowly focused section 23.[151] Congress made an explicit choice to refer to the CFTC's exclusive jurisdiction only in the regulatory arena of information gathering, not in the Anti-Manipulation jurisdictional section at issue here. Thus, with respect to day-to-day regulation, such as gathering data as discussed in NGA section 23, the CFTC's jurisdiction is exclusive and the agencies must work through each other. With respect to enforcement against manipulation as specified in section 4A, jurisdiction is not exclusive and Congress did not include a savings clause. Therefore, Amaranth's arguments about the meaning of this savings clause in section 23 are unpersuasive and, in fact undercut Amaranth's position that Congress intended section 4A to confer only limited jurisdiction to the Commission.

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[149] 149 Cong. Rec. S 10173 at 21 (daily ed. July 30, 2003) (statement of Sen. Bingaman). In our view, Congress' delegation to FERC in new section 4A indicates Congress' recognition that the Commission has expertise to bring to bear on matters of

energy market manipulation. As we noted in the OSC, Commission staff includes experts in both the physical and financial natural gas markets. OSC at P 52.

[150] H. R. Rep. No. 109-49, at 7 (2005).

[151] *See* EPAct 2005 § 316(c)(1).

61. Amaranth also misconstrues the Commission's discussion in the OSC regarding NGA section 23 and its language pertaining to the MOU with the CFTC.[152] The Commission does not contend that section 23 confers jurisdiction over manipulation claims.[153] The statutory authority to issue the OSC comes from section 4A, not section 23. Instead, the Commission states that section 23 supports its construction of section 4A.

62. The Commission largely agrees with Amaranth that section 23 authorizes the Commission to collect information from market participants about the availability and prices of natural gas. Section 23 reflects Congress' recognition of the potential for the Commission and the CFTC to seek the same information, so it required the Commission and the CFTC to coordinate their data gathering activities. However, there is nothing in section 23 that prohibits the Commission from using that information in any investigation of manipulation, nor is there any language in section 23 suggesting that inter-agency coordination under the MOU would not include investigations. It is an odd notion indeed that Congress intended the Commission to gather information pertaining to exchanges under the CFTC's jurisdiction, but if we thereby detected manipulation affecting our jurisdictional markets to have no enforcement role to punish and deter such manipulation. Unremarkably, the MOU itself and the year-long joint Commission-CFTC investigation of Amaranth's conduct illustrate that both agencies (at least until recently) read the statute to contemplate joint investigation activities that go beyond the collection of information when they agreed that: "the CFTC and the FERC may from time to time engage in oversight *or investigations of activity affecting both CFTC-jurisdictional and FERC jurisdictional markets.*" MOU at 3 (emphasis added).

C. <u>The Commission's Assertion of Jurisdiction in the OSC As Compared to Order No. 670</u>

63. Amaranth's final assertion is that the Commission's determination that it has jurisdiction in this matter departs from Order No. 670.[154] Amaranth contends that the statement in Order No. 670 that "this Final Rule does not, and is not intended to, expand the types of transactions subject to the Commission's jurisdiction," is a concession by the Commission that its anti-manipulation subject matter jurisdiction is limited to "wholesale transactions that remain within the ambit of the NGA, NGPA, and FPA."[155] Amaranth's

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[152] Rehearing Request at 16-17 (discussing OSC at P 48).

[153] OSC at PP 3, 44-45.

[154] Rehearing Request at 39-41.

[155] *Id.* at 40.

argument, which takes a few words in Order No. 670 out of context, is unavailing.[156]

64. Order No. 670 clarified that EPAct 2005 broadened the Commission's overall jurisdiction to prohibit any entity, directly or indirectly, from using a manipulative or deceptive device in connection with the purchase or sale of natural gas subject to the jurisdiction of the Commission. In Order No. 670 we delineated the elements essential to manipulation: "an entity: (1). . .engages 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."[157] The language Amaranth points to deals only with the second part of the third element. As stated in Order No. 670, and we reiterate here, EPAct 2005 did not affect the Commission's jurisdiction under NGA section 1(b) to regulate ratemaking of interstate commerce and wholesale transactions of natural gas, and non-affiliated entities.[158] In fact, we agreed with commentators in the Anti-Manipulation Rule rulemaking, and re-affirm here, that the scope of "transactions" in that third element is the same as that covered by pre-existing NGA provisions and was not expanded by EPAct 2005.[159] Consequently, in neither Order No. 670 nor the OSC did the Commission assert that EPAct 2005 expanded the types of jurisdictional transactions that would satisfy section 4A's requirement that the affected markets must be "subject to the Commission's jurisdiction." For this reason, by way of example, we noted that a manipulation pertaining only to a "first sale" would not be covered.[160]

65. However, the broad language of section 4A enlarged the conduct (as identified in the other elements) with respect to those transactions that we can regulate.[161] Order No. 670 elsewhere clearly provides that manipulative or deceptive conduct that affects the very same jurisdictional markets identified in section 1(b) would be subject to the

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[156] NARUC characterized Amaranth's argument as "exceptionally convoluted." NARUC *Amicus* Brief at 11.

[157] Order No. 670 at P 49.

[158] 15 U.S.C. § 717b (2005).

[159] Order No. 670 at P 20.

[160] *Id.*

[161] *Id.* at P 21 (specifically rejecting comment urging that section 4A did not increase the Commission's reach beyond the rules already promulgated).

Commission's broader Anti-Manipulation Rule.[162] Moreover, the statement in Order No. 670 that the new regulations apply where there is a *nexus* between fraud and a jurisdictional transaction (as opposed to conduct that *is* a jurisdictional transaction) is consistent with section 4A's "in connection with" requirement.[163] In this case, the Commission preliminarily finds that the requisite nexus is established because Amaranth's manipulation directly and substantially affected *jurisdictional* transactions. Therefore, the Commission's preliminary findings in the OSC are entirely consistent with EPAct 2005, the Anti-Market Manipulation Rule, and Order No. 670.

III. Conclusion

66. The Commission denies Amaranth's request for expedited rehearing on the issue of the Commission's jurisdiction to punish manipulative trading of NG Futures Contracts that had a direct effect on the price of physical natural gas within the Commission's jurisdiction. The Commission's determination is supported by the language of the NGA; it is consistent with, and does not infringe upon, the jurisdiction of the CFTC; and it furthers the objective of the NGA to ensure that energy markets remain fair and competitive. Our tolling order in this docket, dated September 26, 2007, remains in effect as to all other timely filed rehearing requests. In addition, pursuant to the Notice issued October 12, 2007, Respondents shall now answer the OSC, as specified in P 140(a) and (b) of the OSC, not later than 14 days from the issuance of this Order.

The Commission orders:

Amaranth's request for rehearing is hereby denied.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[162] *Id.* at P 22 ("the Commission views the 'in connection with' element in the energy context as encompassing situations in which there is a nexus between the fraudulent conduct of an entity and a jurisdictional transaction.").

[163] *Id.* at P 16 ("[a]bsent such *nexus to a jurisdictional transaction* . . . fraud and manipulation in a non-jurisdictional transaction (such as a first or retail deal) is not subject to the new regulations.") (emphasis added).