

126 FERC ¶ 61,041  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Seminole Energy Services, LLC  
Seminole Gas Company, LLC  
Seminole High Plains, LLC  
Lakeshore Energy Services, LLC  
Vanguard Energy Services, LLC

Docket No. IN09-9-000

ORDER TO SHOW CAUSE AND NOTICE OF PROPOSED PENALTIES

(Issued January 15, 2009)

1. Pursuant to section 385.209(a)(2) of the Commission's regulations,<sup>1</sup> the Commission's *Revised Policy Statement on Enforcement*,<sup>2</sup> and the Commission's *Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties*,<sup>3</sup> the Commission directs the above-captioned firms (collectively, Respondents) to show cause why they should not be found to have violated section 1c.1 of the Commission's regulations,<sup>4</sup> which prohibits the manipulation of natural gas markets, and why they have not violated the Commission's prohibition against buy-sell arrangements. The Commission further directs the Respondents to show cause why they should not be assessed civil penalties as specified in the attached Enforcement Staff Report and

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<sup>1</sup> 18 C.F.R. § 385.209(a)(2) (2008).

<sup>2</sup> 123 FERC ¶ 61,156, at P 35-36 (2008).

<sup>3</sup> 117 FERC ¶ 61,317, at P 7 (2006).

<sup>4</sup> 18 C.F.R. §1c.1 (2008) (Anti-Manipulation Rule).

Recommendation dated December 31, 2008 (OE Staff Report)<sup>5</sup> in the amount of \$4,250,000 and required to disgorge unjust profits of \$452,194 plus interest, as well as any payment received from entities settling enforcement investigations arising from the bidding for interstate transportation capacity on the Cheyenne Plains Gas Pipeline Company LLC (Cheyenne) pipeline during its March 2007 open season. The Commission directs the Respondents to file such answers with the Commission within 30 days of the date of this order.

2. This case presents allegations by the Commission's Office of Enforcement Staff (OE Staff) of violations of the Commission's Anti-Manipulation Rule and its prohibition against buy-sell transactions. These allegations and the potential civil penalties and disgorgement amounts noted above arose out of an investigation conducted by OE Staff and are described in the OE Staff Report. The OE Staff Report alleges that Seminole Energy Services, LLC (Seminole Energy) used its subsidiary affiliates, Seminole Gas Company, LLC, Seminole High Plains, LLC, Lakeshore Energy Service, LLC, and Vanguard Energy Services, LLC to obtain a larger allocation of interstate transportation capacity on Cheyenne's pipeline than Seminole Energy could have acquired by itself. The OE Staff Report alleges that the affiliates themselves had no use for the Cheyenne capacity; therefore, they engaged in a series of buy-sell transactions to consolidate the value of the capacity for Seminole Energy.

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

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

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

Commission also will determine the amount of any penalties and disgorgement, if appropriate.

The Commission orders:

(A) Within 30 days of the date of this order, Respondents must file answers in accordance with 18 C.F.R. § 385.213 (2008) showing cause why they should not be found to have (1) violated section 1c.1 of the Commission's regulations, and (2) engaged in prohibited buy-sell transactions to consolidate the capacity they acquired in Seminole Energy.

(B) Within 30 days of the date of this order, Respondents must file answers in accordance with 18 C.F.R. § 385.213 (2008) showing cause why their alleged violations of section 1c.1 of the Commission's regulations and the prohibition against buy-sell transactions should not warrant the assessment of civil penalties in the amount of \$4,250,000 and require them to disgorge unjust profits of \$452,194, plus interest, as well as any payment received from entities settling enforcement investigations of bidding on Cheyenne in March 2007.

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

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

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

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

Kimberly D. Bose,  
Secretary.



**FEDERAL ENERGY REGULATORY COMMISSION**

**Seminole Energy Services, LLC  
Seminole Gas Company, LLC  
Seminole High Plains, LLC  
Lakeshore Energy Services, LLC  
Vanguard Energy Services, LLC**

**Enforcement Staff Report and Recommendation**

Office of Enforcement  
Division of Investigations

The Office of Enforcement (OE or Enforcement) reports to the Federal Energy Regulatory Commission (Commission) its findings of fact and conclusions of law regarding Seminole Energy Services, LLC (Seminole), and its affiliates, Seminole Gas Company, LLC (Seminole Gas), Seminole High Plains, LLC (High Plains), Lakeshore Energy Services, LLC (Lakeshore), Vanguard Energy Services, LLC (Vanguard) (together, the Seminole entities) bidding for, and transactions related to, interstate natural gas transportation capacity on Cheyenne Plains Gas Pipeline Company, LLC (Cheyenne) on March 13, 2007.

## **I. Executive Summary**

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

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

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

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

Acting on complaints received from other market participants, Enforcement investigated the bidding on Cheyenne. The complaints were that some bidders submitted multiple bids through affiliated companies in order to game the *pro rata* allocation, that is, to obtain multiple shares of valuable capacity at the expense of market participants

who submitted only a single bid. Enforcement's investigation sought to determine whether any bidders violated Cheyenne's FERC Gas Tariff or any of the Commission's rules or regulations. Among the bidders investigated were the Seminole entities.<sup>1</sup>

As explained in this report, Enforcement staff determined that Seminole used its subsidiary affiliates Seminole Gas, High Plains, Lakeshore, and Vanguard, to submit bids to Cheyenne for the purpose of securing a larger allocation of scarce and valuable Cheyenne capacity than Seminole could acquire by itself. Seminole's affiliates did not have a use for the Cheyenne capacity for their own needs, but instead used the capacity they obtained to transport gas that they bought from Seminole at the Cheyenne receipt point and sold to Seminole at the Cheyenne delivery point.

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

- The Seminole entities were bid to acquire more capacity for Seminole than it could acquire itself.
- Seminole senior management approved the multiple-affiliate bidding, analogizing the availability of capacity to "free turkeys."
- Upon award of the capacity, the Seminole entities engaged in a series of buy-sell transactions to consolidate the value of the capacity they acquired in Seminole.
- Seminole sought the advice of counsel before bidding. Seminole elected to waive its attorney-client privilege. The privileged communications do not eliminate Seminole's intent to defraud.

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

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<sup>1</sup> Simultaneous with this report, Enforcement staff is also submitting a report recommending an Order To Show Cause with respect to the bidding for Cheyenne capacity by National Fuel Marketing Co., LLC and its affiliates (NFM). In addition, staff is submitting four settlements of bidding activity by other companies for the Commission's consideration. Those companies are: Tenaska Marketing Ventures and its affiliates (Tenaska); ONEOK Energy Services Co. and its affiliates (ONEOK), Klabzuba Oil & Gas, FLP (Klabzuba); Jefferson Energy Trading Co., LLC (Jetco); Wizco, Inc. (Wizco); and, Golden Stone Resources, LLC (Golden Stone).

seasons for valuable capacity:

Finally, the Commission takes note of Calpine's requests regarding limitations on the amount of capacity bid and multiple bids from affiliates. Although we are not prohibiting all such bids, we will examine closely any such bids to determine whether they are soundly based on satisfying the legitimate needs of the bidder, or whether they are made to "game" the open season process.<sup>2</sup>

At the time of the Trailblazer bidding, the Commission had broad anti-discrimination authority under the Natural Gas Act (NGA), but lacked anti-manipulation authority. As Trailblazer had followed its procedures and had not engaged in undue discrimination, the Commission took no action on staff's investigation. In 2005, however, the Commission was granted broad anti-manipulation authority by the Energy Policy Act of 2005 (EPAc 2005)<sup>3</sup> and the Commission promptly implemented that authority in Order No. 670,<sup>4</sup> placing all market participants on notice that fraudulent conduct is prohibited.

As the Commission recognized in Order No. 2005, not all multiple-affiliate bids constitute gaming. Consistent with this approach, Enforcement considered the purpose for which bidders sought Cheyenne capacity and only pursued sanctions for companies that subverted the open season process. Staff also considered the holding of *Transcontinental Gas Pipe Line Corp. v. FERC*, 998 F.2d 1313, 1321 (5th Cir. 1993) (*Transco*). In *Transco*, the court held that where the statutory purpose of the NGA could be easily frustrated through the use of separate corporate entities, the Commission is correct to look through the corporate form and treat the separate entities as one and the same for purposes of regulation.

With respect to Seminole, staff concluded that Seminole's subsidiaries had no

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<sup>2</sup> *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, Order No. 2005, FERC Stats. & Regs., ¶ 31,174 at P 99 (2005). While many aspects of the prospective transportation of Alaskan natural gas are unique to those circumstances, the Commission's caution on abuse of open season bidding can be applied to any circumstance in which valuable capacity is offered to prospective shippers.

<sup>3</sup> *Energy Policy Act of 2005*, Pub. L. No. 109-58, 119 Stat. 594 (2005).

<sup>4</sup> *Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. 31,202 (2006). The anti-manipulation rules adopted by the Commission applicable to natural gas transactions are codified at 18 C.F.R. § 1c.1 (2008).

separate or legitimate need or use for the Cheyenne capacity, and that they were acting as a single entity within the meaning of *Transco*.

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

Staff concluded that Seminole's use of bids by its subsidiaries was a device, scheme, or artifice to defraud the other Cheyenne open season bidders. Given the sealed, single opportunity bid process used by Cheyenne, Seminole's multiple affiliate bidding was also an act, practice, or course of business that operated as a fraud or deceit upon the other open season bidders. First, the facts establish that Seminole and its subsidiaries acted as a single entity for the purpose of obtaining additional valuable capacity for Seminole's benefit as compared to the amount Seminole could obtain on its own. The bids by Seminole's subsidiaries were not made to satisfy any legitimate needs of Seminole Gas, High Plains, Lakeshore, and Vanguard. Rather, Seminole orchestrated the actions by its subsidiaries to obtain more capacity for Seminole at the expense of other open season bidders. Second, the facts also show that Seminole acted with the intent to defeat the *pro rata* allocation mechanism – that is, that Seminole acted deliberately and intentionally to obtain a greater share of valuable capacity than Seminole was entitled to. In short, the conduct of the Seminole entities meets the requirements of section 1c.1 and thus constitutes a “transaction for the purpose of impairing, obstructing or defeating a well-functioning market.”<sup>5</sup>

In addition to the violation of section 1c.1, staff determined that Seminole perfected its fraud by engaging in a series of buy-sell transactions. The four Seminole subsidiaries thus violated the Commission's prohibition on buy-sell arrangements. Seminole's conduct also harmed numerous other Cheyenne bidders by reducing the allocation they received of scarce and valuable capacity. As the facts show, most bidders, including companies that are part of large corporate organizations and have multiple affiliates, submitted one bid. The awards to such bidders were reduced because of Seminole's multiple bids.

In the course of the investigation, Seminole was informed both orally and in writing of staff's views, and was invited to apprise staff of any misstatement of fact or error Seminole may perceive in staff's understanding of the facts. Staff also afforded

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<sup>5</sup> Order No. 670 at P 50.



Seminole the opportunity to present any alternate views or defenses. Seminole did not dispute any material facts, but presented several arguments which it believes militate against enforcement action in this case. These arguments will be discussed below.

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

For the reasons explained below, Enforcement staff recommends the Commission issue an Order To Show Cause why the Seminole entities did not violate 18 C.F.R. § 1c.1 and the Commission's prohibition on buy-sell arrangements in connection with the Seminole entities' bids for, and transactions related to, capacity acquired in the March 2007 Cheyenne open season, and why the Commission should not require the Seminole entities to pay a civil penalty of \$4,250,000 and to disgorge unjust profits of \$452,194, plus interest, plus any payments it received from parties settling the Cheyenne matter.<sup>6</sup>

## **II. Background**

### **A. Cheyenne Plains Open Season**

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

On March 6, 2007, Cheyenne posted an open season notice for unsubscribed capacity available in the amounts of 70,000 Dth/d for April and October 2007, and 45,000 Dth/d for May and September 2007. The notice specified that Cheyenne would evaluate all open season bids based on the net present value or NPV of the monthly

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<sup>6</sup> Staff notes that there are companies settling staff's investigation of bidding on Cheyenne that will disgorge unjust profits to the other Cheyenne open season bidders, including to the Seminole entities. Accordingly, staff recommends the Commission order the Seminole entities to show cause why they should not disgorge unjust profits, including the payments they receive from settling companies, plus interest.

reservation charges for each bid consistent with section 21.5 of the General Terms and Conditions of Cheyenne's FERC Gas Tariff. In the event there was not sufficient capacity to meet all winning bids, Cheyenne stated in the notice of open season published on its Electronic Bulletin Board (EBB) that capacity would be allocated *pro rata* based on the maximum delivery quantity of the winning bids. The open season was a closed auction – that is, the bids and identities of the bidders were submitted under seal and only became known when Cheyenne posted the results of the open season on its EBB following the close of the open season on March 14, 2007.

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

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

In March 2007, the difference between the price at which natural gas could be bought at the Cheyenne Wyoming receipt points and sold at the Cheyenne Kansas delivery point significantly exceeded the transportation costs, which meant Cheyenne's capacity was valuable and in high demand. As a result, Cheyenne received 48 bids in its open season, which resulted in 47 winning bidders.<sup>7</sup> Each of these bidders submitted a bid at the highest allowable NPV, that is, for all of the available capacity, throughout the entire term, and at the maximum Tariff rate. Using its *pro rata* allocation mechanism, Cheyenne allocated each winning bidder 1,489 Dth/d for the April/October capacity and 957 Dth/d for the May/September capacity, which amounts to 1/47<sup>th</sup> or 2.1% of the total available capacity.

## **B. Complaints to the Hotline from Market Participants**

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<sup>7</sup> All 48 bidders submitted bids at the highest possible NPV, however one bidder conditioned acceptance of its *pro rata* allocation on receiving a minimum volume of 2,500 Dth/d, and therefore was not awarded any capacity.

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

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

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

### **C. Scope of Staff’s Investigation**

Based on the posting of “winning bidders” on Cheyenne’s EBB, staff’s initial screen for determining who to investigate was by identifying those companies that bid through entities with a common name or otherwise known to staff to be affiliated. As more facts were discovered, staff investigated other entities that were affiliated or had close business relations but whose relationships were not readily apparent.

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

Importantly, staff’s investigation also revealed that multiple-affiliate bidding was not always employed to defeat the *pro rata* allocation mechanism. In two separate cases, the facts established that multiple-affiliate bidding was employed to further the legitimate business interests of each affiliate bidder. In the first case, a large national energy company bid for the capacity through two affiliates, a marketing arm serving wholesale customers, and a retail operation securing capacity to serve its retail customers. The facts showed that the two entities, although affiliated, were bidding for capacity on Cheyenne

that was intended to further their respective businesses. In the second case, a natural gas exploration and production company with assets in Wyoming bid for capacity on Cheyenne to deliver its gas to markets in the Midwest while its affiliated marketing arm bid to serve its wholesale customers. As to these two companies, staff concluded there was no improper conduct in violation of 18 C.F.R. § 1c.1. In both cases, the bids of the affiliates were independent and soundly based on satisfying the legitimate needs of the bidders.

As to the other companies: Tenaska, ONEOK, Seminole, NFM, Klabzuba, Jetco, Wizco, and Golden Stone, staff concluded their conduct in bidding for capacity on Cheyenne violated 18 C.F.R. § 1c.1. Staff was able to resolve its investigation of Tenaska, ONEOK, Klabzuba, Jetco, Wizco, and Golden Stone through settlement. With regard to Seminole and NFM, staff recommends the Commission order both to show cause why they did not violate 18 C.F.R. § 1c.1 in connection with their multiple-affiliate bidding on Cheyenne.<sup>8</sup>

### **III. Seminole and its affiliates**

Seminole, created in 1998, is a privately-held entity that provides retail natural gas services in Oklahoma, Kansas, Texas, Arkansas, Missouri and Mississippi. Seminole markets gas in 13 states and purchases gas from approximately 350 producers. Seminole Gas, High Plains, Lakeshore, and Vanguard are all subsidiaries of Seminole. Seminole Gas gathers, compresses and treats wellhead natural gas on behalf of producing companies. High Plains, formerly known as Post Rock Gas, provides retail natural gas services in Colorado, Wyoming, Nebraska and Kansas. Lakeshore, formed in 2002, provides retail natural gas services in Michigan and Ohio, focusing its service and product offerings primarily on the DTE/MichCon and Consumers systems in Michigan. Vanguard provides retail natural gas services in Illinois and Ohio.

### **IV. Applicable Law**

Upon receipt of the Hotline complaints, staff investigated whether the multiple-affiliate bidding of the Seminole entities was in compliance with Cheyenne's FERC Gas Tariff and the Commission's rules and regulations. As the Cheyenne Tariff is silent on multiple-affiliate bidding, staff concluded that Seminole did not violate Cheyenne's Tariff and focused on whether Seminole's conduct violated 18 C.F.R. § 1c.1. Staff also investigated whether Seminole's purchases and sales of gas related to the capacity acquired on Cheyenne violated the Commission's prohibition on buy-sell arrangements.

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<sup>8</sup> NFM is the subject of another staff report being issued concurrent with this report.

**A. 18 C.F.R. § 1c.1**

As announced by the Commission in Order No. 670, 18 C.F.R. § 1c.1 prohibits an entity from: (1) using a fraudulent device, scheme or artifice, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity; (2) with the requisite scienter; (3) in connection with the purchase or sale of natural gas subject to the jurisdiction of the Commission.<sup>9</sup> Order No. 670 defined fraud generally, that is, “to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market. Fraud is a question of fact that is to be determined by all the circumstances of a case.”<sup>10</sup>

**B. Prohibition on Buy/Sell Arrangements**

In order to provide greater assurance that transfers of capacity from one shipper to another were transparent, the Commission prohibited buy/sell arrangements in Order No. 636 and companion orders.<sup>11</sup> Order No. 636 described a typical buy/sell arrangement, explaining that “[u]nder those arrangements, an LDC will purchase gas in the production area from an end-user or a merchant designated by an end-user. The LDC will ship the gas on its own firm capacity and sell the gas to the end-user at the retail delivery point.”<sup>12</sup> A prohibited buy-sell transaction, therefore, is a commercial arrangement where a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity, ships that gas through its interstate pipeline capacity, and then resells

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<sup>9</sup> Order No. 670 at P 48.

<sup>10</sup> *Id.* at P 50.

<sup>11</sup> *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission’s Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs., January 1991-June 1996 ¶ 30,939, at 30,400 (1992), *order on reh’g*, Order No. 636-A, Stats. & Regs. Preambles January 1991-June 1996 ¶ 30,950 (1992), *order on reh’g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *reh’g denied*, 62 FERC ¶ 61,007 (1993) *remanded in part sub nom., United Distribution Co. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *cert. denied, Associated Gas Distributors v. FERC*, No. 95-1186 (1996), *order on reh’g*, Order No. 636-D, 83 FERC ¶ 61,210 (1998); *see also El Paso Natural Gas Company*, 59 FERC ¶ 61,031, *reh’g denied*, 60 FERC ¶ 61,117 (1992).

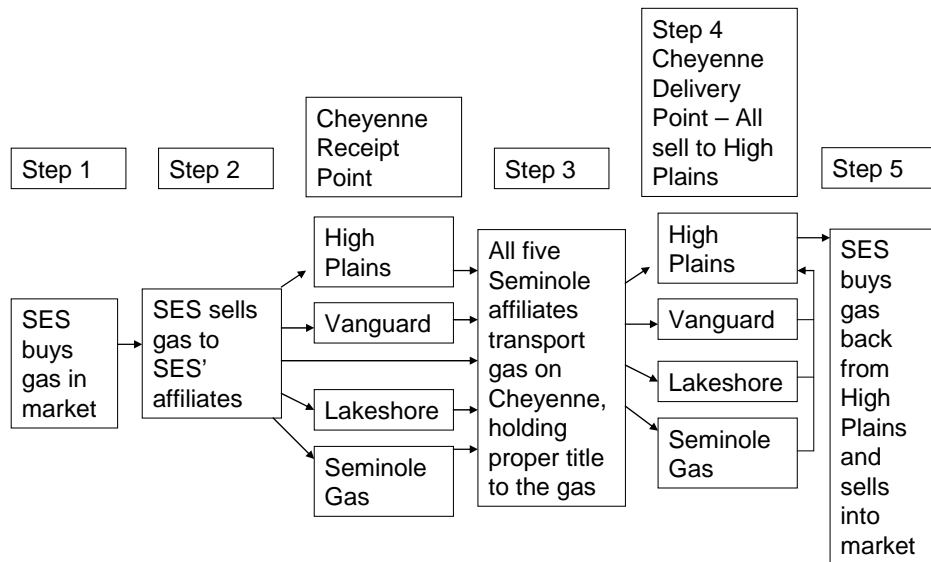
<sup>12</sup> Order No. 636 at 30,416.

an equivalent quantity of gas to the same entity at the downstream delivery point.<sup>13</sup> In Order No. 636-B, the Commission clarified that the buy/sell prohibition applies to all firm capacity holders, not just LDCs.<sup>14</sup>

**V. Staff’s Findings of Fact and Conclusions of Law**

**A. Findings of Fact**

Seminole used its affiliates Seminole Gas, High Plains, Lakeshore, and Vanguard to submit bids along with Seminole and thus secure a larger allocation of scarce UAC 3 open season capacity than Seminole could acquire through its own bid. Seminole Gas, High Plains, Lakeshore, and Vanguard did not have any use for the UAC 3 open season capacity for their respective businesses. Instead, Seminole purchased gas in the market, sold it to Seminole Gas, High Plains, Lakeshore, and Vanguard at the Cheyenne receipt point, the Seminole entities then transported gas using the capacity acquired in the Cheyenne March 2007 open season, and at the Cheyenne delivery point, Seminole Gas, Lakeshore, and Vanguard sold their gas to High Plains which in turn sold the gas back to Seminole. Seminole then sold all of the gas into the market. The diagram below depicts the above-described series of transactions as a series of five steps:



Note: SES is an abbreviation for Seminole Energy Services, LLC (Seminole)

<sup>13</sup> *Williams Energy Marketing & Trading Company*, 92 FERC ¶ 61,219, at 61,715-16 (2000).

<sup>14</sup> Order No. 636-B, 61 FERC ¶ 61,272, at 61,997 (1992); *see also In re BP Energy Co.*, 121 FERC ¶ 61,088, at P 14 (2007).

## 1. Seminole's Motive in Cheyenne

On March 7, 2007, High Plains' trader, Kevin Headrick, sent a High Plains Director, Marc Peter, an e-mail identifying the Cheyenne open season as a potential business opportunity for Seminole. Later that same day, Peter sent the following e-mail to, among others, Daniel M. Frey, Vice President of Business Development at Seminole Energy Services.

<b>From:</b>	Peter, Marc
<b>Sent:</b>	Wednesday, March 07, 2007 3:18 PM
<b>To:</b>	Frey, Dan; Westbrook, Michael; Greene, John; Purcell, Shon
<b>Cc:</b>	Headrick, Kevin
<b>Subject:</b>	Chey Plains Transport - Open Season.xls
<b>Attachments:</b>	Chey Plains Transport - Open Season.xls

Gents,

Kevin put together the attached spreadsheet detailing a Cheyenne Plains open season for excess capacity for the months of April, May, Sep & Oct. Given the fact that this transport is very in the money, it is very likely that this open season will be way over subscribed. Pro-Rata allocations are to be expected.

It is our plan to submit a max rate and volume bid with for 5 SES companies -- SES, SGC, SES-HP, Vanguard and Lakeshore.

Are there any concerns/questions/suggestions? Bids are due by March 14.

Marc--

Frey is a member of senior management at Seminole Energy Services and also a senior manager at three of the four affiliates that bid and were awarded capacity in the Cheyenne open season.<sup>15</sup> Frey stated that High Plains submitted the bids on behalf of the four other Seminole bidders "because they were able to do so and they could secure capacity that was in the money."<sup>16</sup>

On March 12, 2007, Headrick sent Peter another e-mail (shown below), which shows that the Seminole entities used a common bid template prepared by a single

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<sup>15</sup> Frey at 8:25-9:1-13; 14:6-19. At the time of the bids, Michael Westbrook was a Director of Seminole Energy, John Greene was a Vice President of Seminole Energy, and Shon Purcell was a trading analyst with the official title, "Risk Manager" and reported to Westbrook. Seminole Response to Data Request No. 8 (Apr. 9, 2007); E-mail from Shannon Banaga, Counsel for Seminole, to Mark Higgins, Attorney, OE (Feb. 27, 2008).

<sup>16</sup> Frey at 46:24-25. Seminole has also stated under oath that the purpose of the bids was to capture basis spread between the CIG Rockies market and the PEPL Mid-Continent market. Seminole Response to Data Request No. 5(a) (Apr. 9, 2007).

Seminole Energy Services employee; the only difference among the bids was the signature that would accompany each. Headrick's statement that he'll "have one ready for each entity that we're using" is further evidence that the Seminole affiliates were bid only to secure more capacity for Seminole Energy Services.

**From:** Headrick, Kevin [kheadrick@seminoleenergy.com]  
**Sent:** Monday, March 12, 2007 11:36 PM  
**To:** Peter, Marc  
**Subject:** RE: Cheyenne Plains Bid SES

Figured you'd be in bed, I'll put your name in for the hp and ses-denver bid. any thoughts on whether it'll be frey or malackowski for the sgc, vanguard, or lakeshore? I've reviewed a few times, and it's actually due tomorrow at 4 our time. I want to get all neat and tidy so that tomorrow we're good to go. Kevin

-----Original Message-----  
**From:** Peter, Marc  
**Sent:** Monday, March 12, 2007 9:28 PM  
**To:** Headrick, Kevin  
**Subject:** RE: Cheyenne Plains Bid SES

Looks fine but I thought that there was may volume too

Sent from my GoodLink synchronized handheld (www.good.com)

-----Original Message-----  
**From:** Headrick, Kevin  
**Sent:** Monday, March 12, 2007 10:18 PM Central Standard Time  
**To:** Peter, Marc  
**Subject:** Cheyenne Plains Bid SES

<<Cheyenne Plains Bid SES.doc>> Please review, and I'll have one ready for each entity that we're using. Kevin

## 2. Seminole employed its affiliates to submit multiple bids for the benefit of Seminole

As only High Plains operated in the geographic area served by Cheyenne, staff inquired as to what business purpose the four other Seminole affiliates had for bidding on the capacity. Frey testified that that the bids (and awards) were submitted for the benefit of the corporate parent, Seminole.

Q: So, is it correct to say that you bid through five entities in [the] Cheyenne open season so as to secure a larger *pro-rata* allocation than would have otherwise been possible through Seminole High Plains bidding alone?

A: Seminole High Plains bidding alone would have resulted in a single bid being submitted. As we elected to submit the bids, we had five



bids submitted. It's similar to, I guess, if there's somebody giving away turkeys and you have to get in line to get your turkey, you'd send five people down to stand in line, and they would each get a turkey, right?

Q: Right.

A: I mean, that's essentially what we did.<sup>17</sup>

In his deposition, Frey admitted “the justification for Seminole Gas bidding was that we recognized that it was a transaction that could benefit the Seminole Energy Services corporate position.”<sup>18</sup> Frey also stated under oath that “there is an understanding that the parties [Seminole affiliates] collectively help each other to secure more business overall corporately” because “cooperation among these entities has a synergistic effect.”<sup>19</sup> Frey approved the bids.<sup>20</sup>

The e-mail below was sent by Headrick after he learned that the five Seminole entities' bids were each awarded capacity. Headrick's consolidation of the capacity awarded to the Seminole affiliates shows that Seminole Energy Services viewed those bids as one with their own.

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<sup>17</sup> Frey 49:22-50:10.

<sup>18</sup> Frey 26:4-9.

<sup>19</sup> Frey at 50:10-12; 53:4-5.

<sup>20</sup> Frey at 17:23.

**Greene, John**

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**From:** Greene, John  
**Sent:** Thursday, March 15, 2007 9:47 AM  
**To:** Peter, Marc; Westbrook, Michael; Malackowski, Bob  
**Cc:** Frey, Dan; Krebs, James; Boughner, John; Krattenmaker, Don; Purcell, Shon  
**Subject:** RE: Chey Plains Transport Update

Great job boys. Lock and load this baby.

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**From:** Peter, Marc  
**Sent:** Wednesday, March 14, 2007 4:49 PM  
**To:** Westbrook, Michael; Malackowski, Bob  
**Cc:** Greene, John; Frey, Dan; Krebs, James; Boughner, John; Krattenmaker, Don  
**Subject:** FW: Chey Plains Transport Update

FYI

Nice job Kevin. Thanks to all that helped with the fire drill.

Marc-

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**From:** Headrick, Kevin  
**Sent:** Wednesday, March 14, 2007 3:34 PM  
**To:** Peter, Marc  
**Subject:** FW: Chey Plains Transport Update

We were just given verbal notice from Cheyenne Plains that there were 47 entities that bid on the available capacity. Based on that, we were awarded capacity for each month as follows:

April: 7,445/day  
May: 4,785/day  
September: 4,785/day  
October: 7,445/day

The current value of transport is \$625,000 (see attached). I will be developing a hedging strategy tomorrow. We should also expect that our LOC will be lowered to \$250,000.

<< File: Cheyenne Plains Awarded Capacity.xls >>

The “hedging strategy” discussed by Headrick on March 14, 2007 (see above) came into place the following day, March 15, 2007, as shown in the e-mail below. Here again, it is plain that Seminole Gas, High Plains, Lakeshore, and Vanguard were bid for no other purpose than to get more capacity for Seminole Energy Services. The e-mail below also establishes that senior management, specifically Frey and Seminole Energy Services’ President, Robert Rosene, were aware of the transactions at issue. Frey reports to Rosene.<sup>21</sup>

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<sup>21</sup> Frey at 10:10.

**Greene, John**

**From:** Greene, John  
**Sent:** Thursday, March 15, 2007 11:30 AM  
**To:** Rosene, Robert  
**Subject:** FW: Chey Plains Transport Update

FYI

**From:** Headrick, Kevin  
**Sent:** Thursday, March 15, 2007 11:09 AM  
**To:** Purcell, Shon; Malackowski, Bob; Peter, Marc  
**Cc:** Westbrook, Michael; Greene, John; Frey, Dan; Krebs, James; Krattenmaker, Don; Boughtner, John  
**Subject:** RE: Chey Plains Transport Update

Awarded Daily Capacity	CIG Basis	CHEY INDEX	PEPL Basis	Delta	Tot Cost
7445	\$ (2.20)	\$ 0.18	\$ (0.87)	\$ 1.15	\$ 0.40
4785	\$ (2.36)	\$ 0.18	\$ (0.84)	\$ 1.34	\$ 0.40
4785	\$ (2.36)	\$ 0.18	\$ (0.84)	\$ 1.34	\$ 0.40
7445	\$ (2.51)	\$ 0.18	\$ (0.88)	\$ 1.45	\$ 0.40
24460					

**Profits**

Here's the calculated margins based on what was hedged this a.m. Kevin

**From:** Purcell, Shon  
**Sent:** Thursday, March 15, 2007 8:57 AM  
**To:** Malackowski, Bob; Peter, Marc  
**Cc:** Westbrook, Michael; Greene, John; Frey, Dan; Krebs, James; Krattenmaker, Don; Headrick, Kevin  
**Subject:** RE: Chey Plains Transport Update

We have hedged this transaction along with the summer KMI Transport

the total hedges entered into are

apr-oct 5,000/day spread of 1.52  
 Apr 73,350 at a spread of .95  
 Oct 75,795 at a spread of 1.85

Please call with any questions

Shon P. Purcell  
 Seminole Energy Services, LLC  
 Phone 918-477-3422  
 Cell 918-630-2281  
 Fax 918-492-3075

### 3. To Perfect its Fraud, the Seminole Entities Engaged in Prohibited Buy-Sell Transactions

In connection with its multiple-affiliate bidding, Seminole engaged in a series of transactions, which Frey described in his deposition testimony.<sup>22</sup> Frey testified that High Plains submitted the bids on behalf of all the Seminole affiliates and they were all awarded capacity. Frey then described the series of buy/sell transactions Seminole engaged in, which staff summarizes in the diagram on page 11 of this report.

The following e-mail confirms not only that Seminole Energy Services bought all of the gas to be transported using the April capacity acquired by the Seminole entities but

<sup>22</sup> Frey at 87:15-88:23.

also that Seminole senior management were kept apprised of the transactions at issue in this matter.

**Greene, John**

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**From:** Peter, Marc  
**Sent:** Monday, April 09, 2007 10:47 AM  
**To:** Rosene, Robert; Frey, Dan; Barnes, Debbie  
**Cc:** Malackowski, Bob  
**Subject:** FW: Cheyenne Hub Purchases for April

Kevin has listed all of our Cheyenne purchases below. We use this supply to fill our Front Range market and fill the Cheyenne Plains transport. All of the transport gas is sold to SES Tulsa.

Hope this helps.

Marc--

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**From:** Headrick, Kevin  
**Sent:** Monday, April 09, 2007 9:42 AM  
**To:** Peter, Marc  
**Subject:** Cheyenne Hub Purchases for April

Marc, per your request on who we're purchasing gas from in April at Cheyenne. Here ya go.

**CHEYENNE**

Sempra	5,000	IF CIG	0.2200	11/06-10/07
Coral	5,000	IF CIG	0.1500	April '07-March '08
CANTERA	2,350	gdd-CHEY		April '07
Enserco	5,000	IF CIG	0.1300	April '07
Enserco	1,500	IF CIG	0.1600	April '07

## B. Conclusions of Law

### 1. 18 C.F.R. § 1c.1

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

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

As to the first element under 18 C.F.R. § 1c.1, the facts support a finding that Seminole used a device, scheme or artifice to defraud, or that Seminole engaged in an act, practice, or course of business that operated or would operate as a fraud or deceit upon legitimate bidders for Cheyenne open season capacity. Staff views the submission of multiple bids by the Seminole entities for the sole purpose of acquiring a larger share of the *pro rated* Cheyenne capacity for Seminole as such a scheme or artifice. The only explanation offered by Seminole for the bids of its affiliates is that each works in a

“synergistic” fashion to benefit their corporate parent, Seminole. The documents and testimony establish Seminole affiliates’ bids had no discernable purpose other than to gain an uncompetitive advantage in the open season by defeating the *pro rata* allocation mechanism.

In *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971), the Supreme Court cited and quoted with approval the Second Circuit’s holding in *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (“We believe that § 10 (b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws”)(emphasis in original). Whether novel or garden-variety, Seminole’s conduct on Cheyenne was intended to, and did in fact, alter the outcome of the open season to its benefit and to the detriment of other bidders.<sup>23</sup>

Multiple-affiliate bidding was Seminole’s means to commit fraud here. There is no question Seminole engaged in multiple-affiliate bidding. There is also no question the purpose of the multiple-affiliate bidding was to benefit Seminole. Seminole readily admits that it has no “factual dispute” with staff’s findings, and thus does not believe this case requires evidentiary hearing to resolve. Seminole does, however, offer defenses.

Seminole’s defenses to staff’s conclusions of fraud include that it had no notice that its conduct on Cheyenne could be considered fraudulent. In this regard, Seminole relies upon implications it drew from *Pacific Gas Transmission Co.*, 56 FERC ¶ 61,192 (1991) (*PGT*) and *Trailblazer Pipeline Co.*, 103 FERC ¶ 61,225, 61,869 (2003), *order on reh’g and compliance filing*, 108 FERC ¶ 61,049, 61,305 (2004) (*Trailblazer*) that multiple-affiliate bidding of the sort it engaged in is permissible. Conspicuously absent from Seminole’s discussion, however, is any mention of the Commission’s explicit warning regarding multiple-affiliate bidding in Order No. 2005. Staff can only assume Seminole is aware of those Commission statements because it goes to great length to argue, in its own defense, that it is “a legal impossibility” for any other entity to have been unaware of the Commission’s statements in *PGT* and *Trailblazer*, and hence, no one “even could have been” defrauded. Seminole is apparently of the view that its interpretation of prior Commission statements on multiple-affiliate bidding is the only correct interpretation, and the majority of bidders in Cheyenne were wrong to heed the warnings of the Commission in 2005 and staff in 2002 regarding multiple-affiliate bidding in open seasons and, most importantly, to take notice of the Commission’s statements in Order No. 670 that fraud would not be tolerated.

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<sup>23</sup> See *Markowski v. SEC*, 274 F.3d 525, 528 (D.C. Cir. 2001), *cert. denied*, 154 L. Ed. 2d 26, 123 S. Ct. 96 (2003) (noting deceptive conduct intended to affect the result of market activity is fraud).

Seminole further argues that its use of the corporate form in this case is permissible pursuant to the *Copperweld* doctrine,<sup>24</sup> and that in any event, it did not violate 18 C.F.R. § 1c.1 because it lacked the requisite scienter. Seminole claims that it relied on the advice of counsel, and that such reliance amounts to defense under SEC Rule 10b-5 and, by analogy, 18 C.F.R. § 1c.1. Seminole is dismissive of its buy-sell violations notwithstanding the fact that those transactions were the very means by which it perfected its fraud. In light of the facts and circumstances of the case, Seminole's defenses, as will be discussed in context below, are without merit.

### **i. Seminole's Conduct is Analogous to Bid-Rigging**

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

In its defense, Seminole relies on the Supreme Court's opinion in *Copperweld*.<sup>25</sup> In that case, the Supreme Court reversed a Seventh Circuit decision finding that Copperweld had conspired with its wholly owned subsidiary, Regal, in violation of section 1 of the Sherman Act. *Independence Tube Corp. v. Copperweld Corp.*, 691 F.2d 310 (7th Cir. 1982), *rev'd*, 104 S. Ct. 2731 (1984). The trial court had found that Copperweld and Regal conspired to restrain trade in the structural steel tubing market by warning several prospective suppliers and customers against dealing with Independence Tube, a potential competitor. *See Copperweld*, 104 S. Ct. at 2735. In addition to warning

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<sup>24</sup> *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984).

<sup>25</sup> *Id.*

suppliers and customers not to deal with Independence, Copperweld and Regal warned banks and real estate firms. As a result of these efforts, Yoder, a steel tubing mill company, reneged on its agreement to provide Independence with a steel tubing mill. As can be seen, the facts of *Copperweld* have nothing in common with the facts of Seminole's bidding in Cheyenne. Staff does not take issue with the fact that *Copperweld* stands for the proposition that because a parent ultimately controls its wholly owned subsidiary, the two share a "unity of interest." *Id.* at 2742. The holding in *Copperweld*, however, is irrelevant in this matter because staff is not seeking to shoehorn Seminole's conduct into an antitrust violation. Rather, staff uses the antitrust cases to support staff's contention that bidding designed to harm competition is, and has long been deemed, fraud.<sup>26</sup>

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

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

In *Transco*, the court upheld a Commission order that found Transco had used subsidiary affiliates to engage in a complicated scheme to do that which Transco could not do absent the use of subsidiaries. The *Transco* court stated that the "ALJ and the Commission correctly looked behind corporate forms and found that the three companies really were one. For the Commission not to have investigated further would frustrate a statutory purpose by allowing Transco to set up subsidiaries to sell gas at prices at which

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<sup>26</sup> Although the Commission is not bound by the dictates of the antitrust laws, it is obliged to weigh antitrust policy in its NGA deliberations. *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 958-60 (D.C. Cir. 1968). For over a century, an agreement to rig bids has been regarded as illegal *per se*, *i.e.*, "noncompetitive," under the antitrust laws, specifically the Sherman Act. *See, e.g., United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, 278-279 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). Indeed, bid-rigging is one of the "archetypal" anticompetitive agreements found illegal *per se* under the Sherman Act. *See, e.g., Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647 (1980); *Northern Pacific Railway v. United States*, 356 U.S. 1, 5 (1958); *United States v. Brighton Building & Maintenance Co.*, 598 F.2d 1101, 1106 (7th Cir. 1979), *cert. denied*, 444 U.S. 840 (1979).

the company could not legally sell.”<sup>27</sup> Similarly, in *Capital Tel. Co. v. FCC*, 498 F.2d 734, 738, n.10 (D.C. Cir. 1974), the D.C. Circuit held: “[w]here the statutory purpose could be easily frustrated through the use of separate corporate entities a regulatory commission is entitled to look through the corporate entities and treat the separate entities as one for purposes of regulation.”

Staff is doing as the Fifth Circuit instructed in *Transco*: looking through Seminole’s corporate form to determine, consistent with all prior Commission statements on the issue of multiple-affiliate bidding, whether Seminole employed its affiliates to do what it otherwise could not: increase its allocation of capacity.<sup>28</sup> In so doing, Seminole used its corporate form to frustrate two purposes of the NGA. First, the purpose of the NGA is to protect consumers.<sup>29</sup> Pursuant to that mandate, the Commission has promulgated rules and regulations designed to foster an open, competitive natural gas market by *inter alia* ensuring that capacity goes to those who value it most (not to those who bid the most subsidiaries).<sup>30</sup> As discussed below, the bids of Seminole’s affiliates, and the transactions to buy and sell gas from and to Seminole, shielded from public view the real nature of the affiliate bids and, in the process, violated the Commission’s prohibition on buy-sell arrangements which is intended to further the Commission’s open access program regulations under the NGA.

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<sup>27</sup> *Transcontinental Gas Pipe Line Corp. v. FERC*, 998 F.2d 1313, 1321 (5th Cir. 1993).

<sup>28</sup> As discussed *infra*, in Order No. 2005, the Commission stated a general principle that bids of multiple-affiliates are examined to determine whether they are “soundly based on satisfying the legitimate needs of the bidder, or whether they are made to ‘game’ the open season.” Order No. 2005 at P 99.

<sup>29</sup> 15 U.S.C. 717 *et seq.*; see generally *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612, 64 S. Ct. 281, 292, 88 L. Ed. 333 (1944) (NGA is “plainly designed to protect the consumer interests against exploitation . . .”); *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (the Natural Gas Act “fairly bristles with concern for undue discrimination”).

<sup>30</sup> See, e.g., *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, FERC Stats. & Regs. Regulations Preambles (July 1996–December 2000) ¶ 31,091 at 31,300 (2000) (Order No. 637); *order on rehearing*, Order No. 637–A, FERC Stats. & Regs. Regulations Preambles (July 1996– December 2000) ¶ 31,099 at 31,648 (2000) (Order No. 637–A); and Order No. 637–B, 92 FERC ¶ 61,062 (2000) (Order No. 637–B), *aff’d in part and remanded in part*, *Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18 (DC Cir. Apr. 5, 2002), *Order on Remand*, 101 FERC ¶ 61,127 (2002).



Second, as amended by the EPO Act 2005, the NGA's purpose is also to foster well-functioning markets free of market manipulation and fraud.<sup>31</sup> By employing its subsidiaries as it did, Seminole made it impossible for those who valued it equally to share it equally by way of *pro rata* allocation. In this case, Seminole's bidding was not soundly based on satisfying the legitimate needs of Seminole Gas, High Plains, Lakeshore, and Vanguard. Rather, Seminole used its affiliate subsidiaries to grant itself an unfair competitive advantage.

**ii. Commission History With Multiple-Affiliate Bidding Cannot Be Read to Condone Seminole's Fraud**

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

**1. *Pacific Gas Transmission***

The Commission first dealt with the issue of multiple-affiliate bidding in the 1991 *PGT* rate-making proceeding.<sup>32</sup> Here is the entirety of what the Commission said on the subject of multiple-affiliate bidding in its 88-page Order:

We will not require PGT to implement new open-season procedures. While we interpret the open-season procedures as prohibiting PGT from accepting multiple bids from one bidder, we do not read those procedures as prohibiting PGT from accepting separate bids from a parent shipper and its affiliates, as long as each affiliate (which is a separate entity under law) submits one bid.<sup>33</sup>

Contrary to Seminole's assertion, there is no inconsistency between staff's conclusion that the Seminole entities violated 18 C.F.R. § 1c.1 in connection with their multiple-affiliate bidding and the Commission's statements in *PGT*. Staff does not take issue with multiple-affiliate bidding by itself. To be clear, whether multiple-affiliate

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<sup>31</sup> 15 U.S.C. 717c-1 (2008).

<sup>32</sup> *Pacific Gas Transmission Co.*, 56 FERC ¶ 61,192, 61,721 (1991).

<sup>33</sup> *Id.*

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

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

## **2. Trailblazer**

Congress, by the passage of EAct 2005, recognized the need for the Commission to have a rule whereby it could examine all of the transactions subject to its jurisdiction, on a case-by-case basis, and after considering all the facts and circumstances of each case, to determine whether those transactions constitute a fraud. Acting pursuant to the intent of Congress, the Commission promulgated 18 C.F.R. § 1c.1, which broadly speaking prohibits fraud. The Commission lacked this authority in 2002 when the issue of multiple-affiliate bidding next arose.

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

In the first Trailblazer auction, 19 Tenaska companies submitted winning bids. Through Trailblazer's *pro rata* mechanism, the Tenaska companies collectively received 43 percent of the open season capacity. The Tenaska companies then released their capacity to a single Tenaska company. As with Cheyenne today, staff became aware of the bidding behavior of Tenaska on Trailblazer by way of calls to the Hotline from market participants. After being informed of this behavior, and learning that Trailblazer planned to conduct a second auction, staff requested that Trailblazer post on its EBB a notice to the effect that staff was monitoring capacity releases on Trailblazer.

Notwithstanding the notice posted in advance of the second auction, Tenaska repeated its multiple-affiliate bidding when it submitted 23 of 68 “winning” bids in the second auction, and was collectively awarded 34 percent of the capacity. This time, however, the winning Tenaska affiliates did not release their capacity to a single Tenaska company. Rather, one Tenaska company served as an agent for the affiliates and managed the capacity. Trailblazer then conducted a third auction. In the third auction, Tenaska submitted 33 of the 92 bids and was awarded 36 percent of the capacity.

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

As part of a subsequent rate case, Trailblazer requested and received approval to change its tiebreaker mechanism from *pro rata* to first-in-time. Approving this tariff change, the Commission noted “that no single tiebreaker method is definitely better than other methods,” and that “each system has advantages and disadvantages.”<sup>34</sup> The Commission was silent on whether multiple-affiliate bidding of the sort observed in Trailblazer was permissible, and it is a well-settled principle that the Commission speaks through its orders, not the absence thereof.<sup>35</sup>

### 3. Order No. 2005

Trailblazer was not the last time the Commission or its staff addressed the issue of multiple-affiliate bidding prior to the passage of EPAct 2005. In Order No. 2005, the

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<sup>34</sup> *Trailblazer Pipeline Co.*, 103 FERC ¶ 61,225, 61,869 (2003), *order on reh’g and compliance filing*, 108 FERC ¶ 61,049, 61,305 (2004).

<sup>35</sup> *See MidAmerican Energy Holdings Co.*, 118 FERC ¶ 61,003 at P19, n. 45 (2007) (“The Commission, a five-member agency, acts through its written orders, which are ‘issued’ following a favorable vote of the majority. Phrased differently, in the absence of such orders . . . the Commission cannot be said to have acted.” (citations omitted)). *See also Entergy Services, Inc.*, 119 FERC ¶ 61,187 at P52, n.44 (2007); *Indianapolis Power & Light Co.*, 48 FERC ¶ 61,040 at 61,203, n.29 (“The Commission speaks through its orders”), *order on reh’g*, 49 FERC ¶ 61,328 (1989).

Commission stated that multiple-affiliate bidding in open seasons must be examined closely to determine whether the bids are soundly based on satisfying the legitimate needs of the bidder, or whether they are made to “game” the open season process. Order No. 2005 at P 99. Staff believes that Seminole’s conduct is the sort of “game” the Commission was referring to in Order No. 2005 because Seminole and its subsidiary affiliates were acting as one to advance the interests of Seminole.

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

Seminole’s conduct was not a common industry practice. This is perhaps best demonstrated by the fact that the majority of bidders in the Cheyenne open season did not engage in multiple-affiliate bidding to gain an unfair advantage. Further, the misconduct of Seminole and others in the March 2007 Cheyenne open season came to the attention of Enforcement by way of calls to the Hotline from other winning bidders. Even assuming *arguendo* that multiple-affiliate bidding to defeat *pro rata* allocation is a widely used practice, analogy to precedent under SEC Rule 10b-5 establishes that even wide-spread and long-standing industry practices can constitute fraud. For example, in *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266 (3d Cir. 1997), a unanimous en banc Third Circuit found that the execution of stock trades at prices offered on the central National Best Bid and Offer (NBBO) by brokers who failed to investigate other feasible alternatives that potentially offered better prices to the NBBO, albeit the industry standard, could still be considered fraudulent behavior. *Id.* at 274 (“[e]ven a universal industry practice may still be fraudulent”); *accord Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1171-72 (2d Cir. 1970) (non-disclosure of widespread industry practice may still be non-disclosure of material fact); *Opper v. Hancock Securities Corp.*, 250 F. Supp. 668, 676 (S.D.N.Y. 1966) (industry custom may be found fraudulent, especially on first occasion it is litigated) *aff’d*, 367 F.2d 157 (2d Cir. 1966).

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

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

Seminole on the one hand says it does “not contend that the Commission must anticipate and expressly prohibit every possible scheme, artifice, or device designed to manipulate markets before the Commission may impose civil penalties for engaging in the prohibited conduct,” but on the other hand argues that that the Commission should not act in this case because it had no notice its conduct on Cheyenne could violate 18 C.F.R. § 1c.1. Seminole makes this argument with full knowledge, by the advice of outside counsel provided before it bid on Cheyenne, that staff investigated nearly identical conduct on Trailblazer in 2002. Outside counsel advised Seminole that a “business risk” of engaging in its proposed conduct is an investigation by Enforcement. Seminole was aware of the warning staff caused to be posted on Trailblazer’s EBB regarding multiple-affiliate bidding in 2002. Seminole is presumed to have known that the Commission *specifically* warned of improper multiple-affiliate bidding in Order No. 2005. Yet, Seminole still maintains that Enforcement’s conclusion that Seminole violated 18 C.F.R. § 1c.1 “evidences the excessive zeal that has colored Enforcement’s judgment and lead [sic] Enforcement badly astray in this investigation.”

Seminole’s notice arguments ignore not only the Commission’s and staff’s pre-EPAAct 2005 warnings regarding its conduct but also the purpose and effect of Order No. 670: fair notice, consistent with all due process, that transactions subject to the Commission’s jurisdiction must be viewed through the prism of 18 C.F.R. § 1c.1.

In Order No. 670, the Commission codified the statutory prohibition of fraud and manipulation in natural gas markets granted by Congress in EPAAct 2005. Order No. 670 was issued in accordance with the Administrative Procedure Act, 5 U.S.C. § 553 *et seq.*, which establishes the procedural requirements for notice-and-comment rulemaking. The Commission employed public notice-and-comment procedures and gave all interested persons an opportunity to participate in the making of 18 C.F.R. § 1c.1 through submission of written comments. *See generally Long Island Care at Home, Ltd. v. Coke*, 127 S. Ct. 2339, 2351 (2007) (noting that the “object” of notice-and-comment rulemaking under 5 U.S.C. § 553 “is one of fair notice”). Thirty parties filed comments and nine parties filed reply comments, all of which the Commission considered. Upon the issuance of Order No. 670, only one entity requested rehearing (related specifically to a statute of limitations issue), and no one appealed the order.<sup>36</sup>

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<sup>36</sup> *Prohibition of Energy Market Manipulation*, Order Denying Rehearing, 114 FERC ¶ 61,300 (Mar. 22, 2006).

In Order No. 670, the Commission said that 18 C.F.R. § 1c.1 “prohibits the use of employment of any device, scheme, or artifice to defraud. The Commission defines fraud generally, that is, to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market. Fraud is a question of fact to be determined by all the circumstances of a case.”<sup>37</sup> The Commission also set forth the elements that comprise a violation of 18 C.F.R. § 1c.1 so as to reduce regulatory uncertainty and thereby assure greater compliance.<sup>38</sup>

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

#### **v. Seminole’s Policy Arguments are Without Merit**

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

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<sup>37</sup> Order No. 670 at P 50.

<sup>38</sup> *Id.* at P 48.

The bright-line approach to fraud advocated by Seminole is also in direct conflict with the approach relied on by the Commission in a recent case arising under 18 C.F.R. Part 1c. In *DC Energy, LLC v. H.Q. Energy Services (U.S.), Inc.*, the Commission reiterated the view expressed in Order No. 670 that the determination of whether a transaction violates 18 C.F.R. Part 1c is necessarily a fact-specific, case-by-case inquiry.<sup>39</sup>

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

#### **b. Scienter**

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

The facts above, particularly staff's deposition of Frey, provide clear evidence of Seminole's intent to bid Seminole Gas, High Plains, Lakeshore, and Vanguard for the purpose of securing Seminole more capacity to the detriment of the other open season bidders. As Frey said under oath, Seminole viewed the capacity awarded in the Cheyenne open season like someone might view a “free turkey” giveaway.<sup>40</sup> Still more evidence of Seminole's intent is demonstrated by Frey's statements that Seminole's affiliate subsidiaries were employed in the open season to “help” Seminole.<sup>41</sup>

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<sup>39</sup> *DC Energy, LLC v. H.Q. Energy Services (U.S.), Inc.*, 124 FERC ¶ 61,295 (2008), Enforcement Staff Report p. 9 (“ . . . each case will rely on a determination of all the circumstances concerning the entity's conduct. There are no per se violations of Part 1c. Rather, all facts surrounding the conduct must be examined and all of Part 1c's elements must be satisfied”).

<sup>40</sup> Frey at 49:5-8.

<sup>41</sup> *Id.* at 50:4-20.

During staff's investigation, Seminole argued that it relied in good faith on the advice of counsel and, as such, staff should not conclude that Seminole violated 18 C.F.R. § 1c.1. Seminole argued that it lacked the requisite scienter under 18 C.F.R. § 1c.1 because it submitted the Cheyenne bids in good faith reliance on the advice of its expert outside counsel. Seminole also argued that the company's good faith reliance on its outside counsel's advice should eliminate the need for Seminole to pay a civil penalty to resolve the matter. Although staff disputes Seminole's arguments here, staff nevertheless took Seminole's act of seeking counsel into account when arriving at the recommended penalty because staff believes, as a general matter, that such action is to be encouraged.

As the Commission stated in Order No. 673,<sup>42</sup> "SEC Rule 10b-5 does not include provisions for 'good faith' defenses. However, in all cases, the intent behind and rationale for actions taken by an entity will be examined and taken into consideration as part of determining whether the actions were manipulative behavior. The reasons given by an entity for its actions are part of the overall facts and circumstances that will be weighed in deciding whether a violation of the new anti-manipulation regulation has occurred."<sup>43</sup> Similarly, the Fifth Circuit in *United States v. Peterson* stated that "good faith reliance on the advice of counsel is not a defense to securities fraud. It is simply a means of demonstrating good faith and represents possible evidence of an absence of any intent to defraud."<sup>44</sup>

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<sup>42</sup> Order No. 673 rescinded 18 C.F.R. §§ 284.288(a), (d) and (e) and 284.403(a), (d) and (e) of the Commission's market behavior rules, the central purpose of which was to prohibit market manipulation by pipelines that provide unbundled natural gas sales service and by sellers of natural gas for resale at negotiated rates. *Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates*, Order No. 673, 114 FERC ¶ 61,166 (Feb. 16, 2006).

<sup>43</sup> *Id.* at P 24.

<sup>44</sup> *United States v. Peterson*, 101 F.3d 375, 381 (5th Cir. 1996) (upholding the jury instructions of a defendant found liable for securities fraud under SEC Rule 10b-5); accord *Howard v. Securities and Exchange Commission*, 376 F.3d 1136, 1147-1149 (D.C. Cir. 2004) (noting good faith reliance on advice of counsel may be considered as evidence showing due care and good faith, and may be "a relevant consideration in evaluating a defendant's scienter") citing *Bisno v. United States*, 299 F.2d 711, 719 (9th Cir. 1961) ("Advice of counsel is *not* regarded as a separate and distinct defense but rather as a circumstance indicating good faith which the trier of fact is entitled to consider on the issue of fraudulent intent").



Seminole has also sought to heighten the standard of scienter the Commission must show under 18 C.F.R. § 1c.1 to that of a “strong inference” by analogy to two private securities cases, *Saybolt* and *Zonagen*,<sup>45</sup> and by arguing that the Commission adopted such a standard in Order No. 670. In the paragraphs that follow, staff will show that Seminole is mistaken on both points.

The *Saybolt* case involves a claim of legal malpractice with regard to erroneous advice relied upon when Saybolt’s Dutch affiliate bribed a Panamanian official, which is a crime under the Foreign Corrupt Practices Act (FCPA). In discussing the defense of reliance of advice of counsel to a FCPA charge, the court noted that such a “defense . . . is available only to the extent that it might show that the defendant lacked the requisite specific intent, and specific intent to violate the FCPA is not an element of an FCPA violation.”<sup>46</sup> Specific intent is also not a requirement under Part 1c. Order No. 670 at P 52 (“The Commission rejects as unnecessary commenters’ requests to incorporate a specific intent standard into the Final Rule”). In *Zonagen*, an outside patent attorney erroneously advised defendant Zonagen that a patent for one drug covered another drug. The court held that such reliance on bad advice “does not conclusively prove that Defendants did not act with scienter. Good faith reliance on the advice of counsel is not an absolute defense to securities fraud. It represents possible evidence of an absence of an intent to defraud.”<sup>47</sup>

The Commission did not adopt a strong inference standard of scienter in Order No. 670. Rather, the Commission in Order No. 670 cited to the holdings of several circuits that some form of *recklessness* satisfies the scienter requirement. Order No. 670 at P 53 fn. 109 (citations omitted). Seminole confuses the Commission’s statement that “motive and opportunity to commit fraud or conscious behavior sufficient to raise a strong inference of recklessness is sufficient in the Second, Third, and Eighth Circuits” with an endorsement by the Commission that it must prove a strong inference of scienter. *Id.*

As with both the *Saybolt* and *Zonagen* cases discussed above, the “strong inference” standard arises in the context of *private* SEC Rule 10b-5 litigation where, to state a claim for securities fraud, the Private Securities Litigation Reform Act requires that plaintiffs “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2). In marked contrast, in SEC Rule 10b-5 actions brought by the SEC, the First Circuit recently stated

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<sup>45</sup> *Saybolt v. Schreiber*, 327 F.3d 173 (2d Cir. 2003); *In re: Zonagen, Inc. Secs. Litig.*, 322 F. Supp. 2d 764 (S.D. Tex. 2003).

<sup>46</sup> *Saybolt*, 327 F.3d at 183.

<sup>47</sup> *Zonagen*, 322 F. Supp. 2d at 775 (internal citations omitted).

the following:

To establish scienter, we ordinarily require that a plaintiff allege sufficient facts to give rise to a “strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2). We developed this heightened standard in the context of private securities actions “to minimize the chance ‘that a plaintiff with a largely groundless claim will bring a suit and conduct extensive discovery in the hopes of obtaining an increased settlement, rather than in the hopes that the process will reveal relevant evidence . . . .

Here, however, we are evaluating a securities complaint filed by the SEC, not a private actor. Therefore, on its face, the requirements of the PSLRA do not apply. Additionally, the rationales we set forth for a more demanding standard in private securities actions do not apply to this SEC enforcement action. Whereas private parties have a financial incentive to initiate “strike” suits and drag deep-pocketed defendants into court on allegations of fraud in hopes of obtaining a lucrative settlement, the SEC’s statutory task is to protect the investing public by policing the securities markets and preventing fraud. Moreover, as noted above, the SEC possesses the authority to investigate conduct prior to filing a complaint, thereby minimizing the concerns that may result from a lengthy and intense discovery process. . . . The SEC need only allege scienter generally.<sup>48</sup>

On the issue of scienter, Seminole’s reliance on PSLRA cases is misplaced.

In making its argument that its good faith reliance on the advice of counsel precludes a finding of scienter, Seminole cites an SEC Commission decision, *In re Barkate*, 2004 SEC LEXIS 806 (2004). Among the issues in that matter was Barkate’s claims that he relied on a legal opinion prepared by counsel for another that the other’s instruments were not securities. In a footnote, the SEC stated:

Barkate testified that he contacted TLC outside counsel’s office to verify

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<sup>48</sup> *SEC v. Tambone*, 2008 U.S. App. LEXIS 24457 at pp. 27-30 (Dec. 3, 2008) citing *SEC v. Lucent Techs., Inc.*, 363 F. Supp. 2d 708, 717 (D.N.J. 2005) (“[T]he heightened requirements for pleading scienter under the PSLRA do not apply to actions brought by the SEC.”); *SEC v. ICN Pharms., Inc.*, 84 F. Supp. 2d 1097, 1099 (C.D. Cal. 2000) (“[T]he ‘more rigorous’ pleading requirements under the PSLRA, which go beyond the Rule 9(b) requirements only apply to private securities fraud actions; they do not apply to a case . . . brought by the SEC.”).

that [the person who gave him the opinion upon which he claims to have relied] was in fact an attorney. Barkate did not speak to TLC's outside counsel, nor did he hire his own independent counsel before proceeding with the TLC transactions. Barkate has not satisfied his burden of showing that he is not liable because he relied on the advice of counsel. The "advice of counsel" defense does not help Barkate here because he has not met any of its requirements. Contacting the office of an attorney who represents another party, as Barkate did, does not constitute advice of counsel. The "advice of counsel" defense requires that the applicant (1) make a complete disclosure to the attorney of the intended action, (2) request the attorney's advice of the legality of the intended action, (3) receive counsel's advice that the conduct would be legal, and (4) rely in good faith on that advice.

Seminole claims that the facts of its conduct in Cheyenne meet all of the elements set forth in *Barkate*. For at least five reasons, staff disagrees.

First, Seminole did not "make a complete disclosure to the attorney of the intended action." In the e-mails, there is no mention of the structuring (i.e., buy-sells) or the purpose (i.e., defeat *pro rata*) of the multiple-affiliate bids. For all counsel knew at that time, Seminole could have had a legitimate business purpose for each bid.

Second, the question to counsel "Any issues with multiple related parties submitting bids?" is not actually the issue. As staff has consistently maintained, the mere submission of multiple affiliate bids is not a violation of 18 C.F.R. §1c.1. Here, however, Seminole's bids were submitted with the intent of defeating the *pro rata* allocation mechanism in an effort to secure an uncompetitive allocation of the available capacity, thus enabling a single affiliate to sell more gas into the market at the Cheyenne delivery point.

Third, while Seminole's counsel does not appear to have considered 18 C.F.R. § 1c.1 in his advice, counsel did state that "a business risk of making multiple bids by affiliated entities is that an investigation might be conducted by FERC."

Fourth, counsel's advice and consideration of the issue presented was cursory. For example, counsel's advice was delivered via e-mail (at 10:03AM) less than one hour after the question by Frey was asked (at 9:28AM). And in that e-mail, counsel advises his client that he instructed his associate that he was "just looking for a confirmation that there isn't anything new of which I am unaware and not to spend a great deal of time researching the issue."

Fifth, the advice of counsel took on more of a business advisory than a legal opinion. Approximately half of counsel's advice is more business than legal in nature

(e.g., “I certainly do not intend to recommend a strategy that winds up getting you less capacity because of greater capacity limits certain points or selection of less valuable points and then being prorated with a lower amount at the more valuable constrained points . . . I don’t know the precise terms of the available capacity or whether the following strategy is commercially viable, but one thing you may want to consider is not having all the bids identical if different receipt and/or delivery point combinations could be used. If more than one receipt or delivery point is involved, such a strategy might reduce your chances of being prorated”).

Notwithstanding staff’s conclusion that Seminole’s advice of counsel argument does not negate its intent, staff is of the view that Seminole’s mere act of seeking advice before it submitted bids was an important factor that staff did consider and give substantial credit for when considering the appropriate penalty for Seminole’s conduct.

Seminole has also argued to staff that greed alone does not equate with scienter. Staff does not disagree. This case, however, is about more than just sharp business practices or aggressive profit-making, it is about facts and actions that constitute a violation of 18 C.F.R. § 1c.1.

### **c. In connection with**

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

## **2. Prohibition on Buy/Sell Transactions**

As stated above, the Commission prohibits buy/sell transactions to prevent brokering of interstate pipeline capacity or otherwise frustrating the Commission’s open access transportation requirements. Seminole and its affiliates engaged in prohibited buy-sell transactions. Seminole structured its transactions in this way because only it was creditworthy for the purposes of buying and selling gas in the market, a further indication of the illegitimate nature of its subsidiaries’ bids. Therefore, Seminole was in a situation where it could buy more gas than it could transport. However, by bidding its four affiliates in the Cheyenne open season and engaging the buy-sell transactions described above, Seminole could transport five times more gas to market than would have been possible had it bid alone.

The mechanics of Seminole’s buy/sell transactions were best described by Frey himself. Frey testified that High Plains submitted the bids on behalf of all

the Seminole affiliates. They were all awarded capacity. The transactions were hedged and Seminole, the credit-worthy parent company, acquired a portfolio of gas supplies for all of the affiliates. Seminole then sold the gas acquired to each of the four affiliates at the Cheyenne receipt point. All five affiliates scheduled gas on Cheyenne via High Plains, which acted as the other affiliates' agent. All of the affiliates then sold gas to High Plains at the Cheyenne delivery point into NGPL. High Plains in turn sold the gas to Seminole Energy Services at the NGPL pooling point.<sup>49</sup>

## **VI. Sanctions**

### **A. Civil Penalties**

After considering all of the factors set forth in section 22(c) of the NGA, 15 U.S.C. § 717t-1(c), and the Commission's Revised Policy Statement on Enforcement,<sup>50</sup> staff recommends that penalties be assessed against Seminole for its violations of 18 C.F.R. § 1c.1. In the following paragraphs, staff addresses the factors we considered in determining whether a civil penalty should be imposed and, if so, the amount of that penalty. Staff recommends a penalty of \$3,750,000 for Seminole's violations of 18 C.F.R. § 1c.1. Staff also recommends a civil penalty of \$500,000 be assessed for Seminole's violations of the Commission's prohibition on buy-sell arrangements. Together then, staff recommends total civil penalties of \$4,250,000 be assessed against the Seminole entities.

#### **1. Nature and Seriousness of the Offense**

As required by the NGA, one of the broad categories of factors we consider in determining the amount of a civil penalty is the nature and seriousness of a violation.<sup>51</sup> In this case, Seminole's violations, which came to the attention of staff via the Enforcement Hotline, were deliberate and intentional. Seminole employed its subsidiaries as a device, scheme or artifice to defraud. Fraud is among the most serious of violations because it is the sort of conduct that, if unchecked, can cause a loss of confidence in the markets the Commission regulates. In this case, Seminole's bidding on Cheyenne defeated the otherwise efficient and transparent functioning of the *pro rata* allocation mechanism, which is designed to ensure fair distribution among shippers placing the same value on the available capacity.

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<sup>49</sup> Frey at 87:15-88:23.

<sup>50</sup> *Enforcement of Statutes, Regulations, and Orders*, 123 FERC ¶ 61,156, at P 54-71 (2008) (Revised Enforcement Policy Statement).

<sup>51</sup> 15 U.S.C. § 717t-1 (added by EPLRA 2005, § 314(b)).

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

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

The proposed penalty would not imperil Seminole's continued financial viability.

## **2. Cooperation**

Seminole demonstrated satisfactory, but not exemplary cooperation with staff's investigation.

## **3. Reliance on Staff Guidance**

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

As mentioned throughout, staff believes that the bids by the Seminole entities are the transactions that violate 18 C.F.R. § 1c.1. As the bids occurred on a single day, and involve a total universe of five transactions, the maximum penalty available is \$5,000,000. However, considering the fact Seminole sought the advice of counsel before transacting, staff recommends a penalty of \$750,000 for each of the five companies, for a total penalty for market manipulation of \$3,750,000.

Staff also believes Seminole's violations of the prohibition on buy-sell transactions warrant a civil penalty. Here, staff has also considered the precedent developed in the context of capacity release settlements. While the volumes of gas at issue are *de minimis*, staff believes the buy-sell transactions were a means by which Seminole was able to perfect its fraud. As such, staff believes Seminole's buy-sell violations, which occurred with respect to four subsidiaries over the four months of transportation and sales back to Seminole, warrant a civil penalty of \$500,000.

## **B. Disgorgement**

Seminole states that it earned \$452,194 in connection with the capacity it acquired

in the March 2007 Cheyenne open season.<sup>52</sup> Staff recommends the Commission order Seminole to show cause why it should not be required to disgorge this amount, plus interest.

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

## **VII. Recommended Action**

Based on the above conclusions of law and fact, Enforcement recommends the Commission issue the Seminole entities an Order To Show Cause why they did not violate 18 C.F.R. § 1c.1 and the prohibition on buy-sell arrangements in connection with their bids for, and transactions related to, capacity acquired in the March 2007 Cheyenne open season, and why the Commission should not require the Seminole entities to pay a civil penalty of \$4,250,000 and disgorge unjust profits in the amount of \$452,194, plus interest, as well as payments received in settlement with other parties, plus interest.

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

Staff believes the Commission should reserve judgment on whether to set the matter for an evidentiary hearing before an Administrative Law Judge (ALJ). The Commission should have the opportunity to consider Seminole's response to an Order to Show Cause before deciding what, if any matters, merit an evidentiary hearing before an ALJ.

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<sup>52</sup> Seminole Data Response at Attachment A (Nov. 30, 2007).

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

- (a) Seminole, within 30 days of the date of an Order To Show Cause, be required to file an answer showing why it should not be found to have violated 18 C.F.R. § 1c.1 with respect to the March 2007 Cheyenne open season.
- (b) Seminole to show cause, no later than 30 days from the date of an Order to Show Cause, why the Commission should not assess a civil penalty pursuant to the Commission's authority under the NGA in the amount of \$4,250,000 and order Seminole to disgorge unjust profits of \$452,194, plus interest and in addition to payments received from settling parties in the Cheyenne matter, plus interest.



UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Seminole Energy Services, LLC  
Seminole Gas Company, LLC  
Seminole High Plains, LLC  
Lakeshore Energy Services, LLC  
Vanguard Energy Services, LLC

Docket No. IN09-9-000

(Issued January 15, 2009)

MOELLER, Commissioner *dissenting*:

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

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

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

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

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

<sup>2</sup> *Pacific Gas Transmission Co.*, 56 FERC ¶ 61,192 at 61,721 (1991).

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

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

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

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

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

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

<sup>5</sup> NFM Report at 35-36.

<sup>6</sup> Seminole and NFM Reports at 8.

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

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

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

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

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

<sup>8</sup> Seminole Report at 22-23; NFM Report at 25.

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

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

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

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

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

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

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<sup>10</sup> *CCPS Transportation, LLC*, 125 FERC ¶ 61,394 (2008).

<sup>11</sup> *Southern Star Central Gas Pipeline, Inc.*, 125 FERC ¶ 61,082 (2008).

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

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

As part of its investigation of Trailblazer’s open season process, staff asked Trailblazer to notify the industry that bidders could “game” auctions by using affiliate bids.<sup>14</sup> Yet notification by a pipeline is not equivalent to a Commission order – and the

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<sup>13</sup> *Trailblazer Pipeline Co.*, 103 FERC ¶ 61,225 at P 71 (2003), *order on reh’g and compliance filing*, 108 FERC ¶ 61,049 (2004).

<sup>14</sup> Seminole Report at 24. Here is the notice, in full:

As the result of an informal complaint to the FERC following a recent capacity release on the Trailblazer system, Trailblazer has been requested by the FERC Market Oversight and Investigations staff to include the following announcement in this capacity release open season:

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

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

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

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

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

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

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<sup>15</sup> Seminole Report at 24; NFM Report at 27.

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

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

<sup>18</sup> See 18 CFR § 157.32 (2008), which provides in full:

These regulations shall apply to any application to the Commission for a certificate of public convenience and necessity or other authorization for an

(continued)

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

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

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

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Alaska natural gas transportation project, whether filed pursuant to the Natural Gas Act, the Alaska Natural Gas Transportation Act of 1976, or the Alaska Natural Gas Pipeline Act, and to applications for expansion of such projects. Absent a Commission order to the contrary, these regulations are not applicable in the case of an expansion ordered by the Commission pursuant to Section 105 of the Alaska Natural Gas Pipeline Act.

<sup>19</sup> Seminole and NFM Reports at 8.

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

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

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

I respectfully dissent.

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Philip D. Moeller  
Commissioner