

107 FERC ¶ 61,174
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

In the Matter of Amendments to
Blanket Sales Certificates

Docket No. RM03-10-001

ORDER DENYING REHEARING OF
BLANKET SALES CERTIFICATES ORDER

(Issued May 19, 2004)

1. On November 17, 2003, the Commission issued a final rule amending blanket certificates for unbundled gas sales services held by interstate natural gas pipelines and blanket marketing certificates held by persons making sales for resale of gas at negotiated rates in interstate commerce. This rule requires that pipelines and all sellers for resale adhere to a code of conduct with respect to gas sales.¹ As discussed below, this order denies the requests for rehearing and provides several clarifications of the Commission's November 17, 2003 Order.

I. Background

2. In Order No. 644, the Commission explained that the purpose of the code of conduct conditions is to ensure the integrity of the gas sales market remaining within the Commission's jurisdiction, and to continue the Commission's effort to restore confidence in the nation's energy markets. Contemporaneously with Order No. 644, the Commission also issued a rule to require wholesale sellers of electricity at market-based rates to adhere to certain behavioral rules when making wholesale sales of electricity.²

¹ Amendments to Blanket Sales Certificates, Order No. 644, 105 FERC ¶ 61,217 (2003); 68 Fed. Reg. 66,323 (Nov. 26, 2003); 18 CFR §§ 284.288 and 284.403 (2003) (Order No. 644).

² Investigations of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003).

3. Based on the comments received from market participants and further consideration of the issues presented, Order No. 644 modified the provisions of the code of conduct originally proposed in the Notice of Proposed Rulemaking issued on June 26, 2003.³

4. Under the codes of conduct, a pipeline providing unbundled natural gas sales service under section 284.284, or any person making natural gas sales for resale in interstate commerce pursuant to section 284.402, is prohibited from engaging in actions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market rules, prices, or conditions.⁴ Wash trades and collusion with others are included in this prohibition.

5. Sections 284.288 and 284.403 also contain various reporting obligations. To the extent that a pipeline providing service under section 284.284, or any person making natural gas sales for resale in interstate commerce pursuant to section 284.402, engages in the reporting of transactions to publishers of gas price indices, the pipeline or blanket marketing certificate holder shall provide complete and accurate information to any such publisher. Further, such entities must retain for three years all relevant data and information upon which they billed the prices they charged for natural gas they sold pursuant to their market based sales certificate or the prices they reported for use in price indices. Moreover, such entities that engage in reporting must do so consistent with the Policy Statement on Natural Gas and Electric Price Indices, 104 FERC ¶ 61,121 (2003) (Policy Statement), which provides, inter alia, that a data provider should only report each bilateral, arm's-length transaction between non-affiliated companies.

6. Order No. 644 provides that a person filing a complaint alleging a violation of these rules must do so no later than 90 days after the end of the calendar quarter in which the alleged violation occurred. However, Order No. 644 provides that if a person could not have known of the alleged violation, the 90-day time limit will run from the discovery of the alleged violation. In a similar vein, the Commission must act within 90 days from the date it is informed of an alleged violation of these regulations or knew of the potentially manipulative nature of the act. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject action. A violation of these rules may result in disgorgement of unjust profits, suspension or revocation of a pipeline's blanket certificate or other appropriate non-monetary remedies.

³ Amendments to Blanket Sales Certificates, 103 FERC ¶ 61,350 (2003) (NOPR).

⁴ See 18 C.F.R. §§ 284.288 and 284.403.

7. In formulating these code of conduct regulations, the Commission sought to strike a balance among a number of competing interests. For example, while customers must be given an effective remedy in the event anticompetitive behavior or other market abuses occur, sellers must be provided sufficient notice of the rules of the road. In order to ensure that the marketplace will be competitive and well-functioning, we must provide rules prohibiting all market abuses, even those whose precise form and nature are unknown to the Commission at this time. Therefore, in promulgating these rules, the Commission has carefully balanced and accounted for the competing interests, and has ensured that all market abuses are prohibited and that sellers have sufficient notice of the prohibited conduct.

8. Eleven commenters sought rehearing or clarification of Order No. 644.⁵ The issues raised by these commenters include issues relating to: the application of the code of conduct to jurisdictional sellers; the limited jurisdiction of blanket certificates; the general language prohibiting manipulation, as well as the prohibitions of wash trades and collusion; the reporting to index gas publishers; the three-year data and information retention requirement; and finally, remedies. These issues are discussed below.

II. Comments

A. The Commission's Burden of Proof to Institute a Generic Rulemaking

9. Cinergy argues that the Commission has failed to meet its burden of proof under section 5 of the Natural Gas Act (NGA) to justify the imposition of new conditions in existing blanket sales certificates, on a generic basis. Cinergy argues that the Commission failed to show that blanket certificates, as a class, are no longer just and reasonable and that sellers have both market power and the ability to influence market prices, terms and conditions, and that the Commission has failed to prove that requiring the refund condition in blanket certificates is just and reasonable with respect to every natural gas market, every product, and every seller in the country. In particular, Cinergy

⁵ American Gas Association (AGA); Avista Corporation d/b/a Avista Utilities and Avista Energy Inc. (collectively, Avista); BP America Production Company and BP Energy Company (collectively, BP); Cinergy Marketing & Trading, L.P. (Cinergy); Duke Energy Corporation (Duke); Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrill Lynch and Morgan Stanley); National Association of State Utility Consumer Advocates (NASUCA); Nicor Gas; Sempra Energy; Shell Offshore Inc. (Shell Offshore); and Western Gas Resources, Inc. (Western).

argues that the Commission's reliance in Order No. 644 upon the Final Report on Price Manipulation in Western Markets is not reasoned decision-making since the Final Report was based, in part, on non-public information that was not shared with the industry.

10. In its final rule, the Commission recognized that in Order No. 636, it authorized pipelines to make unbundled sales at market-based rates because it concluded that, after unbundling, jurisdictional sellers of natural gas would not retain market power. In Order No. 636, the Commission also noted that Congress had found that a competitive market exists for gas at the wellhead and in the field and required that the Commission maintain and protect the competitive well-head market.⁶ The Commission determined to institute a light-handed regulation regime and rely upon market forces to constrain unbundled pipeline sales for resale gas prices within the Natural Gas Act's "just and reasonable" standard. In Order No. 547, the Commission issued blanket certificates to all persons that were not interstate pipelines authorizing them to make jurisdictional gas sales for resale at negotiated rates with pregranted abandonment authority. The Commission also determined that the competitive gas commodity market would lead all gas suppliers to charge rates that are sensitive to the gas sales market.

11. In this proceeding, the Commission determined that its light-handed regulation of the jurisdictional gas market had been successful and had resulted in substantial economic benefits including lower national energy costs to consumers of over \$600 billion as compared to the continuation of tight regulation.⁷ However, the Commission concluded that in light of its Staff's determination regarding the types of behavior that

⁶ In adopting the Wellhead Decontrol Act, Congress required the Commission to "retain and improve this competitive structure in order to maximize the benefits of decontrol." Order No. 636 at 30,392, citing, H.R. Rep. No. 101-29, at 6 (1989) (emphasis in original).

⁷ 103 FERC ¶ 61,350 (2003) at P10 (citing Center for the Advancement of Energy Markets, California Here We Come: The Lessons Learned from Natural Gas Deregulation by Dr. Rodney Lemon (August 2001)).

occurred in the Western markets during 2000 and 2001,⁸ and by the Commission's experience in other competitive markets, its responsibility to ensure the integrity of the jurisdictional gas sales market required it to revise its regulations to place additional conditions on its grant of market based sales certificates. The Commission determined that such conditions would allow the Commission to fulfill its obligation to appropriately monitor markets and to ensure that market based rates remain within the zone of reasonableness required by the NGA.

12. The anticompetitive and manipulative actions prohibited by these rules are antithetical to the original intent of the grant of blanket market-based sales authority which was intended to "foster a truly competitive market for natural gas sales for resale in interstate commerce, giving purchasers of natural gas access to multiple sources of natural gas and the opportunity to make gas purchasing decisions in accord with market conditions."⁹ Therefore, the original grant of certificate authority to make jurisdictional

⁸ Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003) (Final Report). In its report Staff concluded that markets for natural gas and electricity in California are inextricably linked, and that dysfunctions in each fed off one another during the California energy crisis. Staff also found that spot gas prices during the period studied rose to extraordinary levels, facilitating the unprecedented price increase in the electricity market. The Staff also found that dysfunctions in the natural gas market appear to stem, at least in part, from efforts to manipulate price indices compiled by trade publications.

⁹ Order No. 547, FERC Stats & Regs., Reg. Preambles January 1991-June 1996 at 30,719. The Commission also stated that:

The goal of this rule--in conjunction with the regulations promulgated in Order Nos. 636 and 636-A--is to provide to all merchants of natural gas the "level playing field" that the Commission continually strives to promote. By issuing marketing certificates, this final rule will place gas merchants who are not interstate pipelines on an equal footing with interstate pipeline merchants who are afforded blanket sales certificates pursuant to Order No. 636. Further, and most importantly, the final rule will foster a truly competitive market for natural gas sales for resale in interstate commerce, giving purchasers of natural gas access to multiple sources of natural gas and the opportunity to make gas purchasing decisions in accord with market conditions. As we emphasized in Order No. 636-A, our "policy of relying, to the maximum extent possible, on competitive market forces to balance the supply and demand for natural gas at reasonable prices should be extended to all sales markets." Id.

sales of natural gas implicitly prohibited acts which would manipulate the competitive market for natural gas. In light of the market manipulations in the West in 2000-2001, which occurred despite the implicit prohibitions in gas certificate authorizations and electric energy market-based rate authorizations, the Commission found it necessary, in order to ensure the competitiveness of the market, to explicitly prohibit acts intended to manipulate the natural gas market in its final rule. The Commission implemented these regulations under its authority pursuant to sections 5, 7, and 16 of the NGA.¹⁰ Here, the Commission has determined that a market based authorization for jurisdictional sales service cannot be in the public convenience and necessity unless the conditions promulgated by the instant final rule to ensure a competitive and transparent market are met.

13. The Commission's action in conditioning its grant of certificate authority explicitly places jurisdictional sellers of gas on notice of the type of actions that are prohibited in an effort to maintain a competitive marketplace for natural gas.¹¹ Therefore, the Commission has further ensured that its original intent in fostering a truly competitive marketplace for natural gas will be met.

14. In the instant proceeding, the Commission finds that market based sales of natural gas cannot continue unless subject to the explicit code of conduct set forth in these rules. The rules ensure that the integrity of the competitive natural gas market will not be undermined by manipulative behaviors. The Commission has not found that any particular jurisdictional seller of gas has engaged in the prohibited practices, but rather, that the prohibited practices are unjust and unreasonable, and that their explicit

¹⁰ See also 18 CFR §284.5 (2003) which states that:

The Commission may prospectively, by rule or order, impose such further terms and conditions as it deems appropriate on transactions authorized by this part.

¹¹ For example, in addition to prohibiting jurisdictional sellers from engaging in actions that were without a legitimate business purpose that manipulate or foreseeably could manipulate market conditions, the Commission at section 284.288(A)(1) specifically prohibited "wash" trades which the Commission determined were by their very nature manipulative and devoid of any legitimate business purpose. This is consistent with Commission findings that such wash trades are contrary to the Commission's original intent in authorizing market-based sales. *Enron Power Marketing, Inc., et al.*, 106 FERC ¶ 61,024 (2004).

prohibition is necessary to ensure that market-based sales of gas will be adequately protected from manipulation and, therefore, will be just and reasonable. To this end, the Commission has amended its grant of blanket certificate authority for market based sales to prohibit the types of behaviors which are inconsistent with and cannot exist in a competitive marketplace.

B. Application of Code of Conduct to Jurisdictional Sellers of Natural Gas

15. Nicor Gas argues that the Commission erred in applying the requirements of Order No. 644 to a limited group of sellers, which, they say, places them at a competitive disadvantage. Specifically, Nicor Gas argues that to maintain “first sales” status under the Natural Gas Policy Act of 1978 (NGPA), some wholesalers of natural gas can be expected to be unwilling to engage in transactions with entities subject to these rules, in order to avoid being subject to Order No. 644. Cinergy argues that the code of conduct rules will cause undue discrimination between market participants operating in the Commission regulated and first sales market since the Commission has set up the instant rules which will institute separate standards and penalties for actions in the two markets.

16. The fact that the Commission does not have authority to regulate all sellers in the natural gas market cannot prevent the Commission from explicitly imposing code of conduct rules on all sellers within its jurisdiction which the Commission determined is necessary to prevent the manipulation of prices. Otherwise, the Commission would be prevented from meeting its Congressionally-mandated obligation to ensure a competitive marketplace for sales for resale of natural gas.¹²

17. While recognizing that the code of conduct regulations can be applied only to jurisdictional sellers, the Commission noted that the regulations are intended only to prevent jurisdictional sellers from undermining the competitiveness of the marketplace by engaging in abusive or manipulative acts. On balance, therefore, the Commission determined that the benefits of such rules outweighed any potential market disruptions or burdens on jurisdictional sellers potentially caused by those rules.

¹² AGA requests clarification that an entity not engaged in wholesale sales that otherwise could be, is not considered a “seller” or “holder of a blanket certificate” under these rules, and therefore is not subject to the obligations in section 284.403(b)-(c). The Commission repeats that these code of conduct rules under sections 284.288 and 284.403 apply only to actual jurisdictional sellers: a pipeline providing unbundled natural gas sales service under section 284.284, or any person making natural gas sales for resale in interstate commerce pursuant to section 284.402.

18. Requiring jurisdictional sellers of natural gas to refrain from abusive or manipulative acts will not place jurisdictional sellers of natural gas at any disadvantage in the marketplace other than the disadvantage of being prohibited from engaging in anticompetitive behavior. The competitiveness of a market place is enhanced by rules that require sellers to operate in an open and transparent manner. Accordingly, after a review of the instant requests, the Commission finds that its original determination that its statutory responsibility to ensure just and reasonable rates for the sales over which it has jurisdiction outweighs concerns that a portion of the market will not be subject to these regulations.

C. Jurisdiction Arguments

19. In its final rule, the Commission explained its jurisdiction concerning the resales of natural gas and stated that the Commission's NGA jurisdiction to regulate the prices charged by sellers of natural gas had been substantially narrowed by the NGPA and Congress' subsequent enactment of the Natural Gas Wellhead Decontrol Act of 1989. The Commission stated that as a result of these statutory provisions first sales of natural gas were deregulated. The Commission stated that:

Under the NGPA, first sales of natural gas are defined as any sale to an interstate or intrastate pipeline, LDC or retail customer, or any sale in the chain of transactions *prior* to a sale to an interstate or intrastate pipeline or LDC or retail customer. NGPA Section 2(21)(A) sets forth a general rule stating that all sales in the chain from the producer to the ultimate consumer are first sales until the gas is purchased by an interstate pipeline, intrastate pipeline, or LDC. Once such a sale is executed and the gas is in the possession of a pipeline, LDC, or retail customer, the chain is broken, and no subsequent sale, whether the sale is by the pipeline, or LDC, or by a subsequent purchaser of gas that has passed through the hands of a pipeline or LDC, can qualify under the general rule as a first sale on natural gas. In addition to the general rule, NGPA Section 2(21)(B) expressly excludes from first sale status any sale of natural gas by a pipeline, LDC, or their affiliates, except when the pipeline, LDC, or affiliate is selling its own production.¹³

* * *

¹³ Order No. 644 at P 14 (emphasis added).

The Commission retains jurisdiction of sales of domestic gas for resale by pipelines, local distribution companies and affiliated entities, if the seller does not produce the gas it sells.¹⁴

20. BP and Shell Offshore argue that the Commission's interpretation of "first sales" is more limited than the statutory language of the NGPA, section 2(21)(A), and judicial precedent. BP and Shell Offshore argue that to qualify for "first sales" status, the sale of attributable production should relate to the production of the seller or its affiliate.¹⁵ BP and Shell Offshore argue that the issue raised by the underlined language is whether the Commission intended that in order to qualify for "first sale" exemption the seller must be selling only its own production or whether a seller may also qualify if it purchases its own affiliate's production and resells it in its own name. BP and Shell Offshore argue that if the gas is produced by an interstate pipeline, intrastate pipeline, LDC or any affiliate of the interstate pipeline, intrastate pipeline, or LDC, then the sale of those volumes by any other affiliated entity qualifies as a nonjurisdictional first sale.

21. BP and Shell Offshore argue that the Commission should clarify that to qualify for first sale status, the sale of attributable production would relate to production of the seller or its affiliate. The language referred to by BP and Shell Offshore was an attempt by the Commission to encapsulate section 2(21)(B) of the NGPA. This section states:

Certain Sales not included – Clauses (i), (ii), (iii), or (iv) of subparagraph (A) [relating to the definition of a first sale of natural gas] shall not include the sale of any volume or natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.

22. The Commission's intent in its final rule was to follow this statutory language, and therefore, the Commission will clarify that if the gas is produced by an interstate pipeline, intrastate pipeline, LDC, or any affiliate of an interstate pipeline, intrastate pipeline, or LDC, then the sale of those volumes by any other affiliated entity qualifies as a nonjurisdictional first sale of natural gas. This finding is consistent with the court's

¹⁴ Order No. 644 at P 21 (emphasis added).

¹⁵ See BP's Request for Rehearing at 4-7 (citing City of Farmington, New Mexico v. FERC, 820 F.2d 1308, 1315 (D.C. Cir. 1987)). See also Shell Offshore's Request for Clarification and/or Rehearing at 6.

finding in City of Farmington, New Mexico v. FERC, where the court held that, “More generally, a seller (whether an “interstate pipeline,” an “intrastate pipeline,” a “local distribution company,” or an “affiliate thereof”) is engaged in a “first sale” if it is selling gas produced *either* by the seller itself (“such” seller) *or* by its affiliate (“any affiliate thereof”).”¹⁶

23. Western argues that the Commission has attempted to extend its jurisdiction in contravention of the Natural Gas Policy Act of 1978 by narrowing the definition of “first sales.” Western argues that this attempt lacks statutory support and exceeds the Commission’s authority. Western argues that the Commission erred in asserting that once natural gas is purchased by an interstate pipeline, intrastate pipeline, or LDC, the chain of first sales is broken, and that no subsequent sale, whether the sale is by the pipeline, or LDC, or by a subsequent purchaser of gas that has passed through the hands of a pipeline or LDC can qualify as a first sale. Western argues that the Commission’s construction would make unaffiliated marketers of natural gas, who have no relationship to a pipeline or LDC, subject to blanket sales authority whenever the marketer bought back volumes of natural gas from a pipeline or LDC. Western argues that there is no statutory or policy reason for such a change.

24. The Commission’s explanation of its jurisdiction set forth in the final rule is predicated on the NGA, as limited by the definition of first sales set forth in the NGPA. Section 2(21) (A) of the NGPA defines a first sale of natural gas as:

General Rule.- The term “first sale” means any sale of any volume of natural gas- (i) to any interstate pipeline or intrastate pipeline; (ii) to any local distribution company; (iii) to any person for use by such person; (iv) which precedes any sale described in clauses (i),(ii), (iii); and (v) which precedes or follows any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act.

25. In its final rule, the Commission determined that NGPA section 2(21)(A) sets forth a general rule stating that all sales in the chain from the producer to the ultimate consumer are first sales until the gas is purchased by an interstate pipeline, intrastate pipeline, or LDC. The Commission reasoned that once such a sale is executed and the gas is in the possession of a pipeline, LDC, or retail customer, the chain is broken, and no subsequent sale, whether the sale is by the pipeline, or LDC, or by a subsequent

¹⁶ City of Farmington, New Mexico v. FERC, 820 F.2d 1308, 1315 and n.4 (D.C. Cir. 1987) (emphasis in original).

purchaser of gas that has passed through the hands of a pipeline or LDC, can qualify under the general rule as a first sale on natural gas.

26. Western's argument, that the chain, once broken, can be re-established to allow subsequent sales to be considered as first sales is based upon the premise that Congress did not prohibit this re-establishment in crafting section 2(21)(A) of the NGPA, and that Congress was aware of the possibility of multiple sales of gas in that it provided for first sale treatment for any sale of gas "which precedes any sale" to any interstate pipeline or intrastate pipeline, LDC, or user of natural gas. Western argues that Congress did not further qualify this portion of its definition by adding "so long as the gas has not previously been sold to a pipeline or LDC" as it purportedly would have if it had intended to so qualify its definition of first sales.

27. The Commission does not agree with Western's interpretation of the definition of first sales. Western argues that the chain of first sales may be re-established after it has been broken by a sale to an (i) interstate pipeline or intrastate pipeline, (ii) LDC, or (iii) user of natural gas. This interpretation is contradicted by the plain language of the definition of "first sales," which states that to qualify as a first sale of natural gas the sale must precede any sale described in (i), (ii), or (iii). The sale made by the unaffiliated marketer in Western's argument, or for that matter any sale after the first sale chain has been broken, is a sale that cannot precede any sale described in clauses (i), (ii), or (iii) of the definition of first sales because a prior sale to one of those entities must have been made, and the chain of first sales, would, therefore, be broken.

28. This interpretation -- that the chain of first sales cannot be re-established once broken -- is buttressed by an examination of the practical effects of such action. The NGPA originally set ceiling prices for first sales of natural gas linked to various categories of natural gas for sales of such gas. Once the chain of first sales was broken, the gas sales became subject to the jurisdiction of the NGA. To argue, as Western does, that the chain of first sales could be reestablished would lead to impractical results. This is because the ceiling prices established by the NGPA for a first sale of natural gas would be re-imposed downstream after the gas had been sold pursuant to NGA jurisdiction. This may have the perverse effect of requiring a buyer to accept an NGPA ceiling price for its gas sale which is less than the price it paid for the gas under NGA. Moreover, a further indication that the Commission has reasonably interpreted the definition is shown by clause (v) of the definition,¹⁷ which explicitly provides an exception allowing the

¹⁷ Clause (v) of the definition of first sales allows the first sale chain to be re-established only for sales which precede or follow any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act.

Commission to re-establish a first-sale chain, but only when the Commission determines that it should do so in order to prevent the circumvention of a maximum lawful price established by the NGPA. As the definition explicitly includes a provision allowing the reestablishment of the first sale chain in only one specific circumstance, the Commission reasonably interpreted the definition as not allowing the chain to be reestablished in other circumstances. Therefore, the Commission denies Western's request for rehearing on this issue.

29. Sempra Energy states that the Commission should clarify that the Code of conduct will not modify the Commission's interpretation and implementation of the Mobile-Sierra doctrine. United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956); FPC v. Sierra Pac. Power Co., 350 U.S. 348 (1956); Sempra Energy's Request for Rehearing and Clarification at 7-8 (citing Town of Norwood v. FERC, 587 F.2d 1306, 1303-1315 (D.C. Cir. 1978)). The Commission clarifies that the code of conduct rules were not intended to change its policies regarding the Mobile-Sierra doctrine. Further, these rules will not supersede or replace parties' rights under section 5 of the NGA to file a complaint contending that a contract should be revised by the Commission, pursuant to either the "just and reasonable" or "public interest" standards as required by the subject contract.

D. **Code of Conduct**

1. **General Language Prohibiting Manipulation**

30. Section 284.288(a) of the Commission's regulations provides that:

A pipeline that provides unbundled natural gas service under § 284.284 is prohibited from engaging in actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for natural gas.¹⁸

¹⁸ Section 284.403(a) of the Commission's regulation provides that:

Any person making natural gas sales for resale in interstate commerce pursuant to section 284.402 is prohibited from engaging in actions or transactions that are without a legitimate business purpose and are intended to or foreseeably could manipulate market prices, market conditions, or market rules for natural gas.

31. Avista argues that in order to afford regulated parties fair notice of conduct to be prohibited and to comply with the dictates of due process, as well as to facilitate the efficient operation of competitive wholesale natural gas markets, the Commission should modify the general prohibition on market manipulation to prohibit only clearly-defined acts of market manipulation.¹⁹

32. The American Gas Association (AGA) argues that the rule's anti-manipulation code requires further clarification to afford regulated companies sufficient notice of prohibited conduct. Specifically, AGA argues that the Commission should modify the anti-manipulation rule by: (1) clarifying the legitimate business purpose test so that it offers a "safe harbor" against sanctions for particular trading activities (e.g., maximizing operational flexibility, providing additional credit support, avoiding cash out or penalty exposure under a pipeline's tariff, and engaging in price arbitrage through the use of storage service); (2) deleting the foreseeability concept from the rule; (3) clarifying that it will apply a definition of manipulation in accord with judicial and regulatory precedent,²⁰ and (4) modifying the rule by deleting "market conditions" and "market rules" or at a minimum offering further clarification as to the intended meaning of these phrases. Similarly, Cinergy argues that it is not possible to determine how the term "without a legitimate business purpose" will be interpreted in the future.²¹ BP requests clarification that the Commission's intent with regard to determining if a business transaction has a "legitimate business purpose" is not to second guess the actions of parties freely entering into bilateral or speculative transactions.

¹⁹ See also Merrill Lynch and Morgan Stanley Request for Rehearing at 6, 23; Cinergy's Request for Rehearing at 4-8.

²⁰ Specifically, AGA argues that the Commission should explicitly recognize that manipulation has been defined as comprising the following elements: (1) the trader had the ability to influence market prices; (2) the trader specifically intended to do so; (3) an artificial price occurred; and (4) the trade caused the artificial price. See also Merrill Lynch and Morgan Stanley at 4-5, 11-12 (arguing for the deletion of the foreseeability component since it purportedly legitimizes the use of speculative information that played no role in the market participant's actual transaction or activity).

²¹ See also Duke Energy's Request for Rehearing at 15-19 (arguing that the first sentences of sections 284.288(a) and 284.403(a) are unconstitutionally vague, in particular the phrases "without a legitimate business purpose" and "manipulate market prices, market conditions, or market rules").

33. We decline commenters' request to prohibit only specifically enumerated acts of market manipulation. The general prohibition on market manipulation in these rules is consistent with the dictates of constitutional due process, which requires that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit.

34. The Commission's Market Behavior Rules, including the prohibitions relating to market manipulation, are not unduly vague.²² Constitutional due process requirements mandate that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit.²³ This standard is satisfied "[i]f, by reviewing [our rules] and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform."²⁴ The Commission's Market Behavior Rules satisfy this due process requirement because "they are sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve, would have fair warning of what the regulations require."²⁵

²² In this regard, we note that the due process challenges raised on rehearing are limited to challenges to the Commission's rules on their face, *i.e.*, assertions that the Commission's rules are vague in all possible applications. There are no due process rehearing claims challenging the application of the Commission's rules to a particular case.

²³ See Freeman United Coal Mining Company v. Federal Mine Safety and Health Review Commission, 108 F.3d 358, 362 ((D.C. Cir. 1997) (Freeman)).

²⁴ See General Electric Co. v. EPA, 53 F.3d 1324, 1329-30 (D.C. Cir. 1995) (holding that the agency's interpretation of its rules was "so far from a reasonable person's understanding of the regulations that [the regulations] could not have fairly informed GE of the agency's perspective.").

²⁵ See Freeman, 108 F.3d at 362. See also Faultless Division, Bliss & Laughlin Industries, Inc. v. Secretary of Labor, 674 F.2d 1177, 1185 (7th Cir. 1982) ("[T]he regulations will pass constitutional muster even though they are not drafted with the utmost precision; all that due process requires is a fair and reasonable warning.").

35. The due process standard allows for flexibility in the wording of an agency's rules and for a reasonable breadth in their construction.²⁶ The courts have recognized, in this regard, that regulations cannot list all of the infinite variety of situations to which they may apply and that "[b]y requiring regulations to be too specific, [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation."²⁷ The Supreme Court has further noted that the degree of vagueness tolerated by the Constitution, as well as the relative importance of fair notice and fair enforcement, depend in part on the nature of the rules at issue. For example, in the case of economic regulation (as opposed to criminal sanctions), the vagueness test is applied in a less strict manner because, among other things, "the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process." Village of Hoffman Estates, et al. v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1981).²⁸

36. Applying these standards here, the Commission finds that the Market Behavior Rules satisfy the requirements of due process because they provide sufficient notice of the conduct prohibited: actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for natural gas. Under the rules, sellers will have an opportunity to explain to the Commission why they believe the actions or transactions at issue in a particular case had a legitimate business purpose and/or were not intended to nor foreseeably could manipulate market prices, market conditions, or market rules for natural gas. Whether a specific action or transaction has a "legitimate business purpose" is a case specific matter as that term can only have meaning with reference to a specific seller's own business practices and motives. If a seller has a legitimate business purpose for its actions or transactions, it cannot be found to have violated these rules.

²⁶ See Grayned v. City of Rockford, 408 U.S. 104, 110 (1971) (holding that an anti-noise ordinance was not unconstitutionally vague where the words of the ordinance "are marked by flexibility and reasonable breadth, rather than meticulous specificity.").

²⁷ Ray Evers Welding Co. v. OSHRC, 625 F.2d 726, 730 (6th Cir. 1980).

²⁸ See also Texas Eastern Products Pipeline Co. v. OSHRC, 827 F.2d 46, 50 (7th Cir. 1987) ("Texas Eastern, as a major pipeline company, in which trenching and excavation are a part of its routine, had ample opportunity to know of the earlier interpretation, should have been able to see the sense of the regulations on their face, and if still in doubt Texas Eastern should have taken the safer position both for its employees and for itself.").

37. As the Commission is statutorily charged with protecting market participants not just from those specific types of manipulation of which the Commission is currently aware, but from all types of inappropriate market manipulation, in establishing these rules the Commission has not delineated all specific actions or transactions that would violate the rules. Such delineation is not required by due process. Rather, due process requires only that the rules provide sufficient notice of the conduct prohibited, and that is satisfied here.

38. The Commission's Market Behavior Rules meet the twin objectives of providing sufficient notice of prohibited conduct, while containing enough breadth and flexibility to encompass as yet undiscovered means of market manipulation that may arise in the future. In sum, the Commission's Market Behavior Rules put all market participants on reasonable notice regarding the conduct the Commission seeks to encourage and the conduct it prohibits.

39. The Commission has carefully considered the terms and requirements of its Market Behavior Rules and the comments it received in light of its obligation to assure that market-based rate sales are just and reasonable and the requirement that sellers have reasonable notice of the obligations and prohibitions to which they are subject as participants in a competitive market subject to Commission oversight. We find these rules necessary to assure that rates in the markets at issue will be just and reasonable, and that the rules are consistent with the constitutional requirements of due process.

40. Several parties have argued that intent or foreseeability should not be part of the definition for market manipulation or otherwise request that the definition be modified.²⁹ The Commission declines to modify its definition of market manipulation. The Commission stated in Order No. 644 that to determine whether an activity violated its rules, it would examine all relevant facts and circumstances surrounding the activity to establish to determine its purpose and intended or foreseeable result. If that intended or foreseeable result is the manipulation of market prices, market conditions or markets rules, then the seller will be found to have violated the rule against market manipulation.³⁰

²⁹ See, e.g., NASUCA, Merrill Lynch and Morgan Stanley, AGA.

³⁰ Of course, the concept of foreseeability includes the concept of reasonableness. As defined by Webster's Third New International Dictionary, "foreseeable" means: "being such as may be reasonably anticipated."

41. In considering the foregoing, the Commission will look to determine whether the action or transaction was undertaken with a legitimate business purpose. For example, we explained if the behavior was undertaken to provide service to a buyer with rates, terms and conditions disciplined by the competitive forces of the market, we would find the transaction to have a legitimate business purpose. Since the underlying purpose of an action is not always obvious and conclusions regarding the intent of others are often a matter of judgment, we found that we would base our enforcement of this rule on a careful consideration of the facts and circumstances of the conduct at issue recognizing that intent must often be inferred therefrom. In developing this standard, we recognized that actions without a legitimate business purpose which would foreseeably result in a distorted price not reflective of a competitive market are appropriately attributed to the seller as manipulative acts. Accordingly, our standard looks to place such conduct in context; it considers the facts to discern the purpose of the conduct; and takes action when the seller action was intended to or foreseeably would manipulate the market. All of the foregoing elements are related and the Commission will consider them all in considering potential violations of this rule.

42. In response to the Commission's statement in Order No. 644 at P 41 that "transactions with economic substance in which a seller offers or provides service to a willing buyer where value is exchanged for value will be recognized as reflecting a legitimate business purpose consistent with just and reasonable rates," BP argues that rather than considering whether value is exchanged for value, the Commission should consider whether "assumed value is exchanged for assumed value" no matter the merit of the underlying assumptions, or the ultimate outcome. BP does not believe that a seller should be held to have manipulated the market because a transaction it assumed had value did not have value. However, there is no need to modify the Commission's statement that it will consider whether value is exchanged for value because, as it explained in Order No. 644, the Commission will examine all relevant facts and circumstances surrounding the activity in question to establish whether a legitimate business purpose could be attributed to the behavior.³¹ Part of that examination will include, where relevant, issues regarding assumed value.

43. We also reject NASUCA's request that the Commission clarify that sellers will bear the burden to show that actions were not intended to manipulate the market. The party asserting market manipulation or any other violation of these rules must bear the burden of proving all the elements of the prima facie case. A party's attempt to defend its actions by asserting there was a legitimate business purpose or that it did not intend to

³¹ Order No. 644 at P 39.

manipulate nor could it have foreseen the manipulation, is not a shifting of the burden of proof, but is in the nature of an affirmative defense to the allegation of market manipulation.

2. Wash Trades

44. In its final rule, the Commission set forth section 284.288(a)(1) which provides that:

Prohibited actions and transactions include but are not limited to pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk, and no net change in beneficial ownership (sometimes called “wash trades”).³²

45. NASUCA disagrees with the Commission’s definition of wash trades. NASUCA argues that trades that involve *de minimis* value should be included in the definition of wash trades because such trades could be used to circumvent the rule and manipulate market prices just as easily as wash trades of no value. Merrill Lynch and Morgan Stanley argue that the Commission should clarify the parameters of a prohibited wash trade by limiting the designation to trades that occur at the same delivery point, and requiring prohibited wash trades to be “simultaneous,” or within seconds of each other.³³

46. The Commission declines to modify its definition of wash trades based upon these comments. As the definition now stands parties must purposefully create prearranged off-setting trades with no economic risk, and no net change of beneficial ownership to engage in a wash trade. Such actions have no legitimate business purpose and such behavior, standing alone, constitutes a per se violation of sections 284.288(a) or 284.403(a). While NASUCA has made what appears at first to be a request for a minor modification to the Commission’s definition of wash trades, to grant the requested modification would materially alter and detract from the clarity of the definition. To include trades of *de minimis* values in its definition of wash trades the Commission would be required to include trades that are not offsetting, that have a level of economic

³² Section 284.403(a)(1) applies these same prohibited actions and transactions to “[a]ny person making natural gas sales for resale in interstate commerce pursuant to § 284.402”

³³ See Merrill Lynch and Morgan Stanley’s Request for Rehearing at 13.

value and that result in a net change of beneficial ownership (however small). In addition, the Commission would be required to further define its views regarding what amount of value constituted a *de minimis* amount given the circumstances of the trade.

47. Further, in the Commission's view there is no need to modify its definition to include trades that involve *de minimis* values. While it is conceivable that a series of trades for *de minimis* amounts may be shown through evidence to constitute a scheme to manipulate the market, such action, while not a violation of the Commission's prohibition of wash trades, would constitute a violation of the Commission's behavioral rules against market manipulation.

48. The Commission also declines to limit its definition of wash trades to simultaneous trades that occur at the same delivery point. The Commission's definition is that wash trades are pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk, and no net change in beneficial ownership and that such trades constitute per se violations of sections 284.288(a) or 284.403(a). Pursuant to the Commission's definition, a wash trade must be pre-arranged but the offsetting portion of the trade may be executed at a separate time and/or delivery point. The Commission declines to adopt the suggested modification because this would permit parties to engage in activity that is currently prohibited by merely agreeing to execute the offsetting portion of the trade at a different place or time.

3. Collusion

49. Section 284.288(a)(2) of the Commission's regulations provides that prohibited actions and transactions include but are not limited to:

collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for natural gas.³⁴

50. Avista argues that the anti-collusion rule appears to duplicate the general prohibition on market manipulation and, therefore, the Commission should delete it. It argues that if the Commission maintains that the anti-collusion rule prohibits types of activities not covered by the general prohibition on market manipulation, the Commission should articulate those reasons. Merrill Lynch and Morgan Stanley's argue that the rule

³⁴ Section 284.403(a)(2) of the Commission's regulations contains an identical prohibition.

on collusion needs more guidance, could incorporate antitrust jurisprudence, and should be clarified to state that actions that do not adversely affect prices to a degree that makes them unjust and unreasonable are not covered by the rule.

51. We deny rehearing of the anti-collusion regulation. First, the anti-collusion provision is not duplicative of the general prohibition against market manipulation contained in these regulations. As the Commission previously explained, the anti-collusion provision merely expands on the general manipulation prohibition in these rules by explicitly prohibiting acts taken in concert with another party for the purpose of manipulating natural gas markets. The anti-collusion provision prohibits market manipulation undertaken collectively by more than one market participant. This provision, in conjunction with the general prohibition against market manipulation, means that that Commission's regulations prohibit actions which manipulate the market whether the actions are taken by one entity or two or more entities acting together.

52. Second, as the Commission explained in the Order No. 644, "[a]lthough our regulatory approach includes elements of anti-trust law, it is not limited to the structure of those laws. . . . Therefore, these regulations will be interpreted and enforced by the Commission consistent with our own policies and precedents."³⁵

53. Finally, we deny the request that we clarify that actions that do not adversely affect prices to a degree that makes them unjust and unreasonable are not covered by the rule. That request fundamentally misunderstands that market-based rates can be presumed just and reasonable only if a marketplace is competitive. Any action or transaction in violation of these regulations puts into question the competitiveness of the market in which the violation occurs. Moreover, the purpose of these rules is to ensure the integrity of the natural gas market, and we find that we cannot accomplish that goal if we limit the anti-collusion prohibition as requested. The prohibition as promulgated is necessary to fulfill our obligation to appropriately monitor markets and to ensure that market-based rates remain within the zone of reasonableness.

4. Reporting to Gas Index Publishers

54. Section 284.288(b) of the Commission's regulations provides:

To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or

³⁵ Order No. 644 at P 61.

omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement on Natural Gas and Electric Price Indices, issued by the Commission in Docket No. PL03-3-000 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this regulation of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.³⁶

55. BP requests that the Commission clarify the scope of voluntary reporting, and the extent to which it requires reporting of all transactions. BP recommends that if sellers determine to report transactions on a voluntary basis, then they should not have to report all of their transactions at all trading locations since there may be points where volumes are *de minimis*, or where trading is sporadic. BP believes that if a seller reports at a given sales point, then it should be required to report all of its applicable transactions at that point. Merrill Lynch and Morgan Stanley seek further clarification that when a seller voluntarily reports some, but not all, transactions to price indices, and the index publishers only request certain trade data that are part of the index, the seller will be covered by the safe harbor provisions if it notifies the Commission that it is reporting complete transaction data for the hubs the index publisher requests, but that it is not reporting all transactions.

56. The Commission declines to modify its reporting requirements to index gas publishers. We affirm the requirement as set forth in the Policy Statement, which explained the reporting obligations for data providers: “a data provider should report each bilateral, arm’s length transaction between non-affiliated companies in the physical (cash) markets at all trading locations. Physical (cash) market reporting shall not include financial hedges, financial transactions, or swaps or exchanges of gas or electricity.”³⁷ The Commission subsequently clarified that it would not adopt a suggestion that prices should be reported only at points of high connectivity and liquidity.³⁸ Although data

³⁶ Section 284.403(b) of the Commission’s regulations contains an identical requirement.

³⁷ Policy Statement on Natural Gas and Electric Price Indices, 104 FERC ¶ 61,121 at P 34.3 (2003).

³⁸ See Order on Clarification of Policy Statement on Natural Gas and Electric Price Indices, 105 FERC ¶ 61,282 at P 9 (2003).

providers need not report to more than one index developer, if the participant chooses to report, “all transactions” must be reported for purposes of the safe harbor provisions of the Policy Statement.³⁹ The Commission’s interest in robust price formation, as well as accurate, reliable, and transparent price indices dictates that we reject these requests for exceptions to our reporting requirements for points with *de minimis* volumes or sporadic trading. Similarly, in the interest of the clarity of our rules and the accuracy of price indices, we reject Merrill Lynch and Morgan Stanley’s proposal that sellers be permitted to report some but not all transactions based on an index publisher’s request. As the Commission stated in the Policy Statement, in order to benefit from the safe harbor protections, “completeness” is required of price reporting systems: “Price reporting systems should maximize the amount of useful and appropriate information they collect and disseminate. Complete information should be collected for individual transactions”⁴⁰

57. Further, BP requests clarification of obligations for reporting entities when their “reporting status” changes. BP suggests that the Commission clarify that a “change in reporting status” refers to the initiation of reporting by an entity (if that party had not been reporting at any location prior to notification), or a cessation of reporting at all locations (if that party had been reporting at one or more locations prior to notification).

58. The Commission stated that within 15 days of the effective date of the regulations, entities were required to notify the Commission of whether it engages in reporting and update the Commission within 15 days of any subsequent change to its reporting status. The Commission stated that this requirement to notify the Commission of any change in status with regard to price reporting to indices is an ongoing obligation. Therefore, the initiation of reporting by an entity that had not been reporting, and the cessation of reporting at all locations by an entity that had previously been reporting, are both circumstances included in the Commission’s definition of a change in transaction reporting status that would require Commission notification. We reiterate here that the Policy Statement requires that if an entity reports transactions, it must report transactions for all locations.

³⁹ See Order on Clarification of Policy Statement on Natural Gas and Electric Price Indices, 105 FERC ¶ 61,282 at P 9-12 (2003).

⁴⁰ Policy Statement on Natural Gas and Electric Price Indices, 104 FERC ¶ 61,121 at P 33.2 (2003).

59. Merrill Lynch and Morgan Stanley argue that the Commission should clarify the rules relating to misleading and omitted information.⁴¹ In particular, Merrill Lynch and Morgan Stanley assert that the information must be misleading on an issue that is material to the subject of the communication or submission and creates an artificial price.⁴² Merrill Lynch and Morgan Stanley also maintain that market participants will not violate the code of conduct rules for omissions that occur due to a legal requirement to protect confidential information.

60. The Commission declines to modify its regulations based on Merrill Lynch and Morgan Stanley's requests. The safe harbor good faith reporting presumption is rebuttable. However, the Commission has stated that it does not intend to prosecute, penalize, or refer to other agencies with jurisdiction, parties for inadvertent errors in reporting.⁴³ In making inquiries into any such instance, the Commission has stated that it will consider whether the company followed the error correction procedures in the Policy Statement.⁴⁴ Therefore, entities reporting to index developers committing truly inadvertent errors will not be prosecuted, and those entities following the standards set forth in the Policy Statement will also obtain the benefits of the safe harbor protections in order to further the Commission's goals of encouraging regulatory certainty to the process of reporting transaction data and encouraging more industry participants to contribute to the formation of price indices. Moreover, the Commission declines to modify its regulations so that information must be misleading on an issue that is material

⁴¹ See Merrill Lynch and Morgan Stanley's Request for Rehearing at 18 (citing sections 284.288(b) and 284.403(b): "Seller shall provide accurate and factual information, and not knowingly submit false or misleading information . . .").

⁴² See Merrill Lynch and Morgan Stanley's Request for Rehearing at 18 (arguing that "[i]f a seller provides data that the recipient requested and that data is accurate and complete based on the seller's good faith knowledge at the time of submission, then the seller should be immune from allegations that the data was misleading").

⁴³ See Policy Statement at P 37-38; Order on Clarification of Policy Statement at P 16.

⁴⁴ See Policy Statement at P 33.3 and 34.3; Order on Clarification of Policy Statement at P 16.

in order to violate these rules. Such action would undermine the Commission's goal of obtaining complete and accurate information which will enhance confidence in the marketplace.

61. The Commission notes that the current system of published price indices is voluntary.⁴⁵ Only sellers that choose to report to price index developers must comply with the standards adopted in these rules and the Policy Statement.⁴⁶ However, only if such entities comply with the standards in the Policy Statement, will they obtain its safe harbor protections.⁴⁷ In addition, the Commission has stated that a data provider's duty to report is subject to the appropriate confidentiality agreement with the index developer.⁴⁸ Since all trade data submissions to price index developers will be under uniform confidentiality agreements to protect sensitive transaction data, and since price index developers will have a public code of conduct confirming their commitment to confidential treatment of the data, these conditions provide sufficient protection of confidential information for market participants.⁴⁹ Therefore, the Commission will not further modify its regulations since it has reached a proper balance between protecting sensitive transaction data and ensuring verification of the index and access by the Commission to perform its investigative duties.

⁴⁵ See Policy Statement at P 40.

⁴⁶ These regulations do, however, require sellers to notify the Commission whether or not they report transaction data to price index developers.

⁴⁷ See Policy Statement at P 5 (stating that "the Commission will create a rebuttable presumption that companies and individuals that report trade data to index developers in accordance with the standards adopted here are doing so in good faith, and will not be investigated or subjected to administrative penalties for inadvertent mistakes made in the course of reporting energy transaction information.")

⁴⁸ See Policy Statement at P 34.3-35; see also Order on Clarification to the Policy Statement at P 7 n.2 (stating that "The Commission refrained from making counterparty data part of the reporting practices, but urged participants to amend their agreements and to provide counterparty information where possible").

⁴⁹ See Policy Statement at P 33.1; Order on Clarification of Policy Statement at P 9.

62. Duke notes that in Order No. 644, the Commission adopted the standards set forth in the Policy Statement for transaction reporting and adopted the safe harbor set forth therein as a component of the Commission's enforcement of this rule. Duke states that one element of the safe harbor standards is that such data provider adopt and make public a clear code of conduct that its employees will follow in buying or selling natural gas and in reporting such transactions to index developers. Duke requests clarification that this code of conduct requirement, which has been incorporated into the market based rate sales certificates, is limited to a code that addresses activities in reporting data from natural gas and electricity sales and does not include, for example, proprietary risk management guidelines that govern the conduct of traders in negotiating trades.⁵⁰

63. The Commission clarifies that the published code of conduct requirement for data providers in the Policy Statement, which has been incorporated into the instant rule at sections 284.288(b) and 284.403(b), is intended to address standards of ethical behavior (e.g., honest dealings, following rules, honoring commitments, not manipulating, doing things for legitimate business purposes, etc.). This corporate code of ethical behavior applies to the conduct that employees will follow in buying and selling natural gas and in reporting data from such transactions to index developers. To the extent the conduct of employees in negotiating trades overlaps with their ethical behavior in buying and selling gas, such conduct is contemplated by the ethical corporate code in the Policy Statement. Moreover, the Commission notes that employee conduct in negotiating trades must conform to all the provisions of these code of conduct regulations. However, the Commission notes that data reporting is subject to the appropriate confidentiality agreement with the index developer.

5. Three-year Data and Information Retention Requirement

64. Section 284.288(c) of the Commission's regulations provides:

A pipeline that provides unbundled natural gas sales service under § 284.284 shall retain, for a period of three years, all data and information upon which it billed the prices it charged for natural gas it sold pursuant to its market based sales certificate or the prices it reported for use in price indices.⁵¹

⁵⁰ See Duke's Request for Rehearing at 5, 27-28.

⁵¹ Section 284.403(c) of the Commission's regulations contains an identical requirement.

65. Avista requests clarification that the record retention requirement applies only to primary records used by a seller to bill its counterparties, such as confirms, metering data, and settlement documents. Avista argues that the significant costs on sellers of maintaining secondary records for three years that are not otherwise used in the billing process, such as emails and internal memoranda, outweigh the benefits of requiring retention. Similarly, AGA argues that the Commission should delete the phrase, “all data and information upon which it billed the prices it charged for the natural gas sold,” and replace it with, “contractual documentation upon which a blanket marketing certificate holder billed its customers for sales pursuant to its blanket marketing certificate.”

66. The Commission’s record retention rule requires the retention of all data and information upon which such entities billed the prices they charged its customers or reported to price indices. Accordingly, if a record was relied upon to bill counterparties, regardless of the medium in which the record is maintained (whether a contractual document, email, or other form), it must be retained for three years. The Commission requires the retention of such records in order that it might follow the sale transaction from its initiation to conclusion. Therefore, the Commission requires the records that the company relied upon in order to bill its customers without distinctions or ambiguous classifications, such as between primary and secondary records which may be created to obfuscate the billing trail of the transaction.

67. Merrill Lynch and Morgan Stanley request that the Commission revise the record retention provision so that sellers are only required to retain documents or data on which they “actually relied” to bill a counterparty for the natural gas sold. The Commission has already stated that sellers are not required to retain “cost-of-service” or analytical data related to seller’s sales.⁵² We see no need to modify the regulations to include an express reliance component as Merrill Lynch and Morgan Stanley suggest since reliance is implied by the language “upon which it billed.”

E. Remedies

1. General Issues

68. Section 284.288(d) of the Commission’s regulations provides:

Any violation of the preceding paragraphs may subject Seller to disgorgement of unjust profits from the date when the violation occurred.

⁵² See Order No. 644 at P 80.

Seller may also be subject to suspension or revocation of its blanket certificate under § 284.284 or other appropriate non-monetary remedies.⁵³

69. Cinergy argues that the Commission has exceeded its authority under section 7 of the NGA by attempting to impose vague certificate conditions and retroactive ratemaking, specifically proscribed under section 5 of the NGA.⁵⁴ Further, Cinergy maintains that the Commission has exceeded its authority under section 7 of the NGA by attempting through certificate conditions to shift the burden of proof required under section 5 of the NGA away from complainants and to sellers under blanket sales certificates.

70. Duke Energy requests clarification that disgorgement will be limited to the transaction period covered by the complaint; and that complaints alleging violation of a conduct rule are subject to the procedural requirements that ordinarily apply under section 5 of the NGA. Further, Duke Energy requests clarification that (1) in exercising its discretion to order disgorgement for behaviors it believes are not specifically prohibited, the Commission will place significant weight on the degree to which the violation is self-evident, *i.e.*, so plainly manipulative as to be foreseeable as prohibited by the rule; and (2) the Commission will use existing procedural mechanisms (*e.g.*, opinion letters, technical conferences, streamlined petitions for declaratory order) to provide opportunities for market participants to obtain Commission review of specific actions or circumstances.

71. NASUCA argues that the Commission's decision to limit monetary remedies to disgorgement will not deter market participants from engaging in manipulative, abusive or anti-competitive behavior. NASUCA urges the Commission to adopt a make-the-market-whole or other monetary remedy in addition to disgorgement.

⁵³ Section 284.403(d) of the Commission's regulations contains an identical provision.

⁵⁴ See also Duke Energy's Request for Rehearing at 3, 8-11 (arguing that the Commission's ordering of "retroactive refunds" in the code of conduct rules depart from the limitations of sections 4 and 5 of the NGA, and would harm rather than advance the goal of robust competitive wholesale markets); see also Merrill Lynch and Morgan Stanley's Request for Rehearing at 3-4 (arguing that the Commission failed to explain the statutory or legal basis for its claimed authority to "disgorge profits or impose other remedies retroactively" or its complaint and investigation procedures).

72. In its final rule the Commission determined that the appropriate remedy for violations of its behavioral rules may include disgorgement of unjust profits,⁵⁵ suspension or revocation of the blanket sales provision or other appropriate non-monetary remedies.⁵⁶ In the Commission's view it is not necessary to meet its objective of maintaining a competitive marketplace by utilizing a remedy that would make the market whole as some parties suggest. However, the Commission stated that any finding of an appropriate remedy will depend on the circumstances of the case before it and that the Commission would not predetermine which remedy or remedies it will utilize. The Commission took this action because while its discretion is at its zenith when effecting remedies devised to arrive the maximum reinforcement of the Congressional objectives in the Natural Gas Act,⁵⁷ it must, in exercising this discretion, explore the equitable considerations,⁵⁸ the practical consequences of its action and the purposes of the Natural Gas Act.⁵⁹ Therefore, the Commission declined to delineate any particular remedy as the most appropriate for violations of its rule without a case before it so that it could devise a remedy which would take these considerations into account.

⁵⁵See e.g., *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249 (1986) (revenues collected through a seller's market manipulation in excess of a just and reasonable rate may be subject to disgorgement).

⁵⁶ If Congress grants the Commission additional remedial power, including the authority to levy civil penalties, the Commission will, in addition to the remedies set forth herein, implement such authority and utilize it when appropriate for violations of these Behavioral Rules. We strongly endorse Congressional legislation that would provide the Commission with additional civil penalty authority for violations of our orders, rules, and regulations.

⁵⁷ *Niagara Mohawk Power Co. v. FPC*, 379 F.2d 150 (D.C. Cir. 1967).

⁵⁸ *Continental Oil Co. v. FPC*, 378 F.2d 510 (5th Cir.1967).

⁵⁹ *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962). Furthermore, while the Commission must devise an appropriate remedy, the courts have found that the remedy chosen by the Commission need not be the only appropriate, or the most appropriate remedy which might have been devised. *Gulf Oil Corp. v. FPC* 563 F.2d 588 (3rd Cir.1977), cert. denied, 434 U.S. 1062 (1978), reh'g denied, 435 U.S. 981 (1978).

73. As the Commission explained in Order No. 644, the Commission may impose a remedy for a violation of a certificate condition from the time the violation occurred. The Commission has authority under the NGA to require a jurisdictional seller to return unjust profits made in violation of its certificate authorization. In *Consolidated Gas Transmission Corporation, et al.*, 771 F.2d 1536, 1551 (D.C. Cir. 1985), the court found that FERC had authority, pursuant to sections 7 and 16 of the Natural Gas Act, to order retroactive refunds when a gas company had improperly collected money under a tariff that conditioned a certificate of public convenience and necessity.⁶⁰ Therefore, the disgorgement provision is consistent with the Commission's authority under sections 7 and 16 of the NGA to remedy violations of certificate conditions.

74. The Commission denies Duke's request that we limit refunds in the case of a rules violation to the quarterly period in which the violation is found to have occurred. While we are mindful of the seller's need for transaction finality, as a general proposition, the balance of interests in this particular context may require us to extend our disgorgement remedy to the entirety of the seller's improperly-obtained revenues, *i.e.*, to those revenues found to be in excess of that which would have been obtained absent manipulation. However, we will grant the clarification sought by Duke regarding the discretion that will be exercised by the Commission in enforcing its rules. In exercising our discretion to determine the appropriate remedy for violations of our rules, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior as part of our review of the facts and circumstances of the case.

75. Furthermore, we reiterate that remedying a violation of a certificate condition is different from Commission action under section 5 of the NGA. While a seller may not know that its existing rates are unjust and unreasonable until we so find, a seller knows the conditions applicable to its certificate authority before it provides service under the certificate, including that disgorgement may be ordered for violations of those conditions. Thus, in a remedial proceeding under NGA §7 and regulation section 284.288(d) or 284.403(d) the rule against retroactive ratemaking is not implicated. The regulated entity has notice of the conditions applicable to its certificate as of the time the conditions were implemented. Remedies for violations of a condition may, therefore, appropriately be imposed as of the date the condition was implemented.

⁶⁰ See also *Consolidated Gas*, 771 F.2d at 1550 (“We hold that FERC has the authority under § 16 of the Natural Gas Act to order retroactive refunds to enforce conditions in certificates.”).

76. Commentors have also requested that the Commission set forth administrative procedures beyond which the Commission has already enumerated for these proceedings. The Commission will not set forth any particular procedural schedule, or mechanism, other than those presented in the instant order, to examine such cases of violations of its certificate conditions, except to note that it will consider cases in an administratively efficient manner.

2. 90-Day Time Limit on Complaints

77. Sections 284.288(e) and 284.403(e) state that:

Any person filing a complaint against a pipeline for violation of paragraphs (a) through (c) must do so no later than 90 days after the end of the calendar quarter in which the alleged violation occurred unless that person could not have known of the alleged violation, in which case the 90-day time limit will run from the discovery of the alleged violation. The Commission will act within 90 days from the date it knew of an alleged violation of these code of conduct regulations or knew of the potentially manipulative character of an action or transaction. Commission action in this context means a Commission order or the initiation of a preliminary investigation by Commission Staff pursuant to 18 CFR section 1b. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject action or transaction. Knowledge on the part of the Commission will take the form of a call to our Hotline alleging inappropriate behavior or communication with our enforcement Staff.

78. In its final rule the Commission modified its original proposal to allow 90 days from the end of the quarter from which a violation occurred for a party to bring a complaint based on these regulations rather than the originally proposed 60-day limit. The Commission found that a 90-day time period provided a reasonable balance between encouraging due diligence in protecting one's rights, discouraging stale claims, and encouraging finality in transactions. The Commission provided two exceptions to the 90-day limit in that it declared that the time to file a complaint does not begin to run until a reasonable person exercising due diligence should have known of the alleged wrongful conduct and that the Commission would be required to act within 90 days from the date it knew of an alleged violation of these code of conduct regulations or knew of the potentially manipulative character of an action or transaction. The final rules states that if the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject action or transaction.

79. Sempra Energy argues that these exceptions are unnecessary, encourage stale claims, and create an open-ended liability that will have a chilling effect on trading and investment. Sempra Energy recommends that for allegations received after the expiration of the time to file a complaint, the Commission should adopt remedies, such as the issuance of formal warnings or cease and desist directives, which would preserve the regulatory certainty that time limitations impose.

80. Cinergy also contends that the two exceptions to the 90-day deadline provide incentives for frivolous litigation, convey undue leverage on buyers, and ignores harm to the market caused by lack of finality to transactions. Cinergy argues that if a complaint is filed or an investigation is initiated by the Commission: (1) the burden should remain on the complainant or Commission to prove that the challenged rate is unjust and unreasonable, (2) the rules should explicitly incorporate section 385.206 of the Commission's Rules of Practice and Procedure (including the sworn affidavit requirement) as the means by which a complaint may be filed and the specificity by which the violation must be alleged, and (3) complainants should be required to produce evidence in the complaint that is specific to the market participant and the transaction in question, that alleges specific acts of wrongdoing, and that quantifies and explains the precise methodology for quantifying the harm claimed. Avista argues that the Commission should clarify the complaint procedures to ensure sellers are provided sufficient transaction finality. Specifically, Avista suggests that where grievances are related to price anomalies, there can be little justification for complaining after the 90-day period. Avista requests clarification that any complainants that file after the 90-day deadline carry a heavy burden in demonstrating that they could not have known of a violation within the 90-day time period. Similarly, Avista recommends that complainants not be permitted to circumvent the time deadlines for filing complaints by sitting on their rights and later calling the Commission Hotline.⁶¹ Merrill Lynch and Morgan Stanley argue that market participants alleging that certain activities or transactions violate the code of conduct rules should be required to have a good faith basis for their allegations, and that the Commission should consider sanctioning market participants for frivolous complaints.

⁶¹ See also Merrill Lynch and Morgan Stanley's Request for Rehearing at 23; Duke Energy's Rehearing at 3, 5-8 (asking that the Commission tighten the windows during which revenues remain exposed to potential refund, and requesting that the Commission modify the exceptions to the 90-day time limitation or, at a minimum, establish a date certain (e.g., one year after the end of the relevant calendar quarter) after which the Commission will rely on remedies other than "retroactive refunds" of transaction revenues).

81. The Commission will not modify its 90-day time limitation or its exceptions to this limit for bringing claims under these rules. Commenters have stated their concerns regarding the need for finality in transactions. While the Commission acknowledged the importance of rate certainty in its final rule and does so again here, the need for rate certainty must, in this instance, be balanced against the fact that many market abuses are not immediately apparent and market participants may need time to discover and verify that abuses have occurred. These exceptions provide the balance to protect the interests of those persons that may have been adversely affected by violations of the code that are not readily apparent. As the Commission recognized in its final rule, the time limitations are an attempt to provide a reasonable balance between encouraging due diligence in protecting one's rights and finality in transactions while discouraging stale claims.

82. The language which states that the time-limit will run "unless that person could not have known of the alleged violation" is an important part of the balance reached by the Commission. This language ensures that a reasonable person exercising due diligence will have a sufficient time-period to discover hidden wrongful conduct and submit a claim within 90 days of the end of the calendar quarter in which it discovered the alleged violation. The party initiating a complaint more than 90 days after the violation occurred will be required to make an adequate showing to convince the Commission that it could not have known of the alleged violation during the 90-day period following the calendar quarter in which the violation occurred.

83. As the Commission also may not be aware of actions or transactions that potentially may violate our rules within 90 days of the potential violation, the rule similarly allows the Commission to act regarding a potential violation within 90 days from the date it knew of the alleged violation of these code of conduct regulations or knew of the potentially manipulative character of an action or transaction.

84. Furthermore, the Commission will not require that a specific procedural format be established solely for the enforcement of the instant rules. The Commission will certainly act on properly filed complaints under its complaint rules. However, the Commission finds no reason to institute new rules for sanction of frivolous allegations at this point, however, the Commission will not look with favor upon such complaints. In addition, the Commission may act on information received via its Hotline procedures or other communication with the Commission's Enforcement staff and establish investigations based upon such information if it finds sufficient substance to the allegations to warrant further investigation. Commenters have pointed out that parties may inform the Commission of possible wrongdoing after the 90-day deadline if the Commission was previously informed and thereby circumvent the 90-day deadline rule because, as fashioned, the 90-day deadline rule for the Commission runs from the time the Commission knew of the possible violations. Parties allege that this is a loop-hole

which may be exploited by parties sitting on their rights and later informing the Commission after the expiration of the deadline for parties to bring claims. However, the advantage gained by such dilatory tactics is unclear at this point. Moreover, because the Commission is charged with maintaining a competitive marketplace and ensuring just and reasonable rates, it is necessary for the Commission to investigate all appropriate allegations as they are brought before us.

The Commission orders:

The Commission denies the requests for rehearing and provides clarification as discussed in the body of this order.

By the Commission. Commissioner Kelly concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of Amendments to
Blanket Sales Certificates

Docket No. RM03-10-001

(Issued May 19, 2004)

KELLY, Commissioner, concurring:

I strongly support the Commission's effort to require that pipelines and all sellers for resale adhere to a code of conduct with respect to gas sales. I am writing separately because I concur on the issue of the remedies that may be applied for violations of these behavioral rules.

This order appropriately upholds the determination in Order No. 644 that any violation of the rules would subject the seller to remedies, which include disgorgement of unjust profits, suspension or revocation of the blanket sales provision, or other appropriate non-monetary remedies. However, I do not believe that the Commission should exclude a make-the-market-whole remedy as a possible monetary remedy for rule violations.

Suede G. Kelly