

December 17, 2003

Magalie Roman Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Amendments to Blanket Sales Certificates
Docket No. RM03-10-000

Dear Secretary Salas:

Please find for e-filing, the Request for Rehearing on behalf of the National Association of State Utility Consumer Advocates, in the above-referenced proceeding. Copies of this document have been served upon all parties designated on the Commission's official service list, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure.

Very truly yours,

/S/ Denise C. Goulet

Denise C. Goulet
Senior Assistant Consumer Advocate

Enclosure
cc: All parties

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Amendments to Blanket Sales Certificates : Docket No. RM03-10-000

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES'
REQUEST FOR REHEARING

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, the National Association of State Utility Consumer Advocates ("NASUCA") respectfully seeks rehearing of the Commission's Final Rule in the above captioned docket. NASUCA applauds the Commission in the issuance of this final rule as an important step toward ensuring the competitiveness of natural gas markets and the accuracy, liquidity and transparency of price indices. However, NASUCA has determined that several concerns remain unaddressed by the Commission's Final Rule, and consequently NASUCA seeks rehearing of four issues: a) the intent requirement in the market manipulation rule; b) the failure to include trades of *de minimis* value as well as trades of no value in the definition of wash trade; c) the extension of safe harbor protection to the refund remedy; and d) the failure to adopt monetary remedies in addition to disgorgement. We will address each in greater detail below.

Specification of Error

The Commission should reconsider the following errors in the Final Rule adopted in this proceeding:

- a) The Commission's decision to include an intent element in the prohibition against market manipulation impermissibly shifts the burden of proof to complainants or the Commission, imposes on the Commission too heavy a burden of going forward in a situation where complainants or the Commission may not have access to all the necessary data, and does not comport with reasoned decision-making;
- b) The Commission's decision to exclude *de minimis* value wash trades from the definition of wash trades is unsupported, arbitrary and capricious and fails the test for reasoned decision-making since *de minimis* value wash trades could be used to circumvent the rule and manipulate market prices just as easily as wash trades of no value;
- c) The Commission's decision to extend safe harbor protection against refund remedies as well as against the penalty provisions of the Policy Statement in Docket No. PL03-3-000, *Price Discovery in Natural Gas and Electric Markets*, 104 FERC ¶ 61,121 (2003) (hereinafter "Price Indices Policy Statement"), fails the test for reasoned decision-making as there is no justification for requiring consumers to bear the burden of inadvertent mistakes made by market participants; and
- d) The Commission's decision to limit monetary remedies to disgorgement fails the test for reasoned decision-making as disgorgement will not deter market participants from engaging in manipulative, abusive or anti-competitive behavior.

Summary of Argument

The Commission should reconsider its decision to require an intent standard in the prohibition against market manipulation. The language adopted will require consumers, complainants and the Commission itself to prove that the entity being investigated for market manipulation was engaged in an illegitimate business action, *i.e.*, that there was no legitimate business purpose for the action, as well as to prove that the entity intended to manipulate the market.

This is a heavy burden to place on those without access to the information necessary to make a prima facie case on intent. NASUCA is concerned that few complaints will be investigated in an evidentiary hearing if the burden of proving a prima facie case on intent is shifted to complainants or the Commission. Thus, the protection afforded by the Final Rule will be minimal at best, thus defeating the objectives sought in the Final Rule. If the Commission rejects reconsideration on this issue, the Commission should at a minimum clarify that the burden of proof as to intent is on the entity with access to the data and information, *i.e.* the entity being investigated.

The Commission should also reconsider the definition of wash trade and modify that definition to include trades of *de minimis* value as well as trades at no value. Traders could easily circumvent the definition adopted in the Final Rule at little cost to themselves by structuring a wash trade so that exchange occurs at minimal value. Such a transaction would constitute manipulation and leave consumers unprotected. There is no rational justification for excluding such trades from the definition and thereby exposing consumers to potential manipulation.

The Commission should further reconsider its decision to extend safe harbor protection from remedies under this rule as well as from penalties under the Price Indices Policy Statement. While NASUCA does not propose to penalize market participants for inadvertent errors in reporting prices to price indices, there is no rational justification for shifting responsibility for those errors to consumers who have no control over the price reporting process while letting those with control over the process, *i.e.* the corporate entities reporting the trades, to escape any responsibility for the errors. Shifting such a heavy burden to consumers will substantially weaken the protection to be afforded by the new regulations, and does not comport with the Commission's responsibility under the

Natural Gas Act , 15 U.S.C. § 717 *et seq.* to protect consumers from manipulation at the hands of those with market power.

Finally, the Commission should reconsider its decision to reject monetary penalties other than disgorgement. Disgorgement alone will not deter those intending to manipulate markets as there is no consequence for “going for gold” if all the bad actor has to do when manipulation is detected is disgorge the ill-gotten gains. As the U.S. District Court for the Southern District of New York recognized in a recent Securities and Exchange Commission (“SEC”) appeal, additional monetary remedies or penalties are necessary to actually deter manipulative, abusive or anti-competitive behavior. *SEC v. Ballesteros*, 253 F.Supp.2d 720, 731 (S.D.N.Y. 2003) NASUCA urges the Commission to include a “make the market whole” remedy, as well as a monetary penalty. At a minimum, the Commission should clarify that it will use its monetary penalty authority in Section 21 of the Natural Gas Act, 15 U.S.C. § 717t, in cases of severe or substantial abuses. Failure to use all tools available to the Commission to deter and stop these abuses does not comport with reasoned decision-making.

Argument

A. The Commission Erred In Requiring That Intent To Manipulate Be One Of The Criteria For Determining Whether Prohibited Market Manipulation Has Occurred.

The Commission initially proposed that the market manipulation rule would prohibit “actions or transactions without a legitimate business purpose that manipulate or attempt to manipulate market prices, market conditions or market rules . . . or that result in prices that do not reflect the legitimate forces of supply and demand.” 103 FERC ¶ 61,350 at ¶ 11. NASUCA submitted comments urging the Commission to eliminate the “without a legitimate business purpose” language due to the difficulty in proving intent and the legal delays that are sure to follow in litigating

differing interpretations of “legitimate business purpose.” Nevertheless, the Commission in the Final Rule revised this language as follows: “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.” 105 FERC ¶ 61,217 ¶ 27. The Commission’s revision thus appears to impose a dual intent standard: first to determine whether the business purpose is legitimate and second to determine whether the action is intended to manipulate markets. NASUCA urges the Commission to reconsider its approach on this matter.

The Commission’s definition of “legitimate business purpose” in the proposed rule is an action which does not manipulate the market. 103 FERC at ¶ 11. In the Final Rule, the Commission determined that any action which manipulates the market would be inherently without a legitimate business purpose and would be prohibited. 105 FERC at ¶ 35. The Commission further stated that retention of the language in the rule provided sellers “some latitude in determining their business actions” *Id.* NASUCA remains concerned that this language fails to add clarity for either sellers or consumers. Consequently, the Commission must stand firm by its statement that an action or transaction which manipulates the markets could not have a legitimate business purpose attributed to it under the rule. 105 FERC ¶ 35.

However, the Commission’s decision in the Final Order to add the intent requirement to this Market Behavior Rule has upset the balance of seller and consumer interests and fails the test for reasoned decision-making. The Commission should reconsider its decision in the Final Rule to adopt an additional intent requirement by adding the language that the action(s) complained of must be “intended to, or foreseeably could” manipulate markets. 105 FERC at ¶ 27. Consumers and other market participants will only see the results of market manipulation in the form of high prices

or lack of access to supply. These entities are unlikely to have access to the data necessary to “prove” that the seller “intended” to manipulate the markets. Often, such data or information is gained only after the opportunity for significant discovery. Consequently, making intent an element of the prohibited behavior could impose on complainants and the Commission the undue burden of having to make a prima facie case on intent when these entities will have no access to the data or information necessary to prove such claims.

The Commission states at Paragraph 36 of the Final Rule that they are trying to strike a “necessary balance” between protecting “market participants”, and presumably consumers, from market abuses while providing sellers sufficient clarity as to the type of transactions that are prohibited and maintaining flexibility to address future types of abusive transactions that could occur in the future. *Id.* at 36. However, adding the intent requirement does not achieve the goal of clarifying the rule for sellers. Instead, it imposes a substantial burden on consumers, complainants and the Commission, thus erecting a significant barrier to bringing such complaints.

Consumers, market participants and the Commission are not likely to have access to the data or information needed to prove “intent” to manipulate without the opportunity for extensive discovery. Discovery only occurs in the context of a litigated case. If the requirement to show intent is imposed at the complaint filing stage, it would be nearly impossible for consumers, market participants, claimants or the Commission itself to make such a showing.

The burden of proof regarding intent should remain with the entity that has the best access to the information needed to assess such claims, *i.e.* the sellers. Imposing such barriers to bringing complaints on consumers and other market participants does not comport with reasoned decision-making, especially where there is little benefit gained in clarity of the rule. The Commission should

delete this language, or at a minimum should clarify that intent to manipulate is not an element of a prima facie case and that the burden to show that the actions were not intended to manipulate the market remain on the sellers.

B. The Commission Erred In Excluding Trades Of De Minimis Value From The Definition of Wash Trades.

In the proposed rule, the Commission prohibited wash trades because of the manipulative nature of such transactions. 103 FERC at ¶ 12. The proposed rule defined a wash trade as one with no economic risk or no net change in beneficial ownership. *Id.* NASUCA urged the Commission to redefine wash trade to also include transactions which involve “little or” no economic risk, and “little or” no change in beneficial ownership. NASUCA reasoned that trades with small economic risk or small changes in beneficial ownership could nonetheless result in significant manipulation because the gains through such *de minimis* changes could easily outweigh the minimal economic cost. Thus, such trades, like the trades for no value, allow the parties to significantly inflate market prices. In the Final Rule, the Commission did not adopt this recommendation, yet did not discuss why it was rejecting this recommendation. The Commission should reconsider its definition of wash trade to include transactions of *de minimis* value.

The Commission in discussing the “legitimate business purpose” language focused on “value being exchanged for value” as a transaction consistent with just and reasonable rates. 105 FERC at ¶ 41. The Commission defined wash trades as transactions with no economic risk. *Id.* at ¶ 54. Value is usually defined as something of substance, i.e. more than a *de minimis* amount. Consequently, a wash trade for a nickle could hardly be said to constitute value. The *de minimis* payment will likely exist solely for the purpose of circumventing the “no value” definition, while at the same time providing substantial gain to those engaging in such transactions and significantly

raising prices. The transaction is no less abusive just because a minimal amount is paid as opposed to having no net payment reflected in the transaction. The Commission should reconsider its definition and adopt the language recommended by NASUCA

C. The Commission Erred In Extending The Safe Harbor Provisions of The Price Indices Policy Statement To The Remedies Adopted In This Rule.

The Commission's proposed rule did not specifically seek inquiry on the issue of whether it should extend the safe harbor provisions contemplated in the proposed Policy Statement relating to the Price Indices docket to the remedies to be adopted in this rulemaking docket. However, NASUCA urged the Commission not to allow market participants to escape liability for their inadvertent errors at the expense of consumers by extending the safe harbor provisions here. While it may make sense not to penalize such market participants for such inadvertent errors, NASUCA argued that those participants should bear the burden of their mistakes, and not consumers who had no control over such transactions. The Commission's Final Rule nonetheless adopted a safe harbor provision in this docket as well as in the Price Indices Policy Statement docket. 105 FERC at ¶ 71. However, the Commission nowhere discusses the merits of NASUCA's arguments against such a measure. The Commission erred in failing to address NASUCA's concerns on these matters.

The Commission's failure to protect consumers from the inadvertent mistakes of market participants does not comport with the Commission's obligations under the Natural Gas Act, 15 U.S.C. § 717 *et seq.* to ensure that consumers pay only just and reasonable rates for natural gas supply. As the Commission has often noted, published natural gas price indices are widely used by LDC's to establish prices in gas purchase contracts and by state regulators in performance based ratemaking proceedings. The harm that will befall the customers of LDC's due to inflated gas price indices is the same whether the inflation was due to mistakes or intentional manipulation.

Consumers deserve no less protection from such mistakes than they do from outright, intentional abuses. Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717d and 717e, charges the Commission with protecting consumers from unjust and unreasonable prices, not from unjust and unreasonable prices that stem from intentional as opposed to unintentional actions.

Those in control of the trades, *i.e.* the market participants, should be responsible for mistakes, not those at the mercy of those participants. There is no justification for requiring consumers to bear the burden of increased prices that stem from market participant mistakes. Only by holding these market participants accountable for the actions of their employees will the Commission ensure that such mistakes are few and far between. Absolving market participants of any responsibility for those mistakes by allowing excessive prices to flow through permanently to consumers is unjust and unreasonable and the Commission sets forth no justification for such an outcome. While NASUCA does not propose penalizing such participants for their mistakes by opposing adopting the safe harbor provisions in the Price Indices Policy Statement, there is no rationale for extending the safe harbor provision to the remedies imposed under this Final Rule. NASUCA urges the Commission to consider its arguments on this issue and not provide safe harbor provisions in cases brought under this Final Rule.

D. The Commission Erred In Not Adopting A Make The Market Whole Or Other Monetary Remedies In Addition To Disgorgement And Non-Monetary Remedies.

The only monetary remedy for market abuses adopted by the Commission in the Final Rule was the disgorgement remedy. 105 FERC at ¶ 95. NASUCA applauds the Commission's adoption of the disgorgement remedy as an important step forward in protecting consumers from the types of market abuses prevalent in the California markets in 2001. The Commission recognized in Paragraph 88 of the Final Rule, that several parties, including NASUCA, commented that disgorgement in itself is not a deterrent to bad behavior as such a remedy merely places the seller in the same position it would have been in had it not engaged in the bad behavior at the outset. Thus, NASUCA recommended that the Commission include a "make the market whole" remedy or adopt monetary penalties in addition to the disgorgement remedy in this Final Rule. The Commission nowhere discusses the merits of these arguments or the reasons why it has rejected a make the market whole remedy or the penalty remedies.

NASUCA presented several options for making the market whole. The first would hold all entities benefitting from a violation of the regulations accountable to consumers, regardless of whether that entity itself engaged in such behavior or merely relied upon prices set by those engaging in such behavior. A second option would be to require only those actually engaging in the abusive, manipulative or anti-competitive behavior to disgorge their ill-gotten gains. A third option would be the equitable remedy of restitution, *i.e.* holding the entity engaging in the illegal behavior accountable for making the market whole. NASUCA recommended the latter option, arguing that such a policy would protect all consumers, would allow transaction certainty for innocent market participants who just relied on prices and provided a substantial deterrent to engaging in the

prohibited behaviors. The Commission could use a class action Section 5 complaint proceeding much as it did in the California investigations to determine which entities engaged in the prohibited behaviors and are thus to be held accountable. The Commission apparently rejected this proposal, but nowhere discusses the reasons for such rejection. The failure to address NASUCA's concerns constitutes error and the Commission should reconsider NASUCA's proposal.

In addition to proposing a make the market whole remedy, NASUCA urged the Commission to adopt other monetary remedies such as the penalty powers set forth in Section 21 of the Natural Gas Act, 15 U.S.C. § 717t. Section 21 allows the Commission to seek penalties against jurisdictional entities that violate its orders or rules. The Final Rule clearly qualifies for this remedy. The Commission notes at Footnote 70 of the Final Rule that it may not have the authority to impose civil penalties. Whether the penalties to be imposed under Section 21 are civil penalties or some other type of penalty because the Commission must seek such a penalty remedy in Court, the threat of such action would clearly serve as a strong deterrent to the manipulative, abusive and anti-competitive behavior sought to be terminated by this rule. The Commission never discussed why it rejected use of this authority to ensure compliance with this critical Final Rule. Failure to address this issue constitutes error and the Commission should reconsider this issue and put all market participants on notice that it intends to use all penalty authority in its discretion to ensure compliance.

Conclusion and Prayer for Relief

The Commission's decisions in the Final Rule in this docket related to incorporation of an intent requirement in the prohibition on manipulation, failure to include *de minimis* wash trades in the definition of wash trades, extension of safe harbor protection against the remedies provided for

in this Final Rule, and failure to implement additional monetary penalties as remedies do not comport with reasoned decision-making. In each case, the Commission either failed to address the concerns raised by NASUCA in its comments in this docket, or failed to properly balance seller and consumer interests.

WHEREFORE, the National Association of State Utility Consumer Advocates respectfully requests that the Commission reconsider its rulings on these issues and modify or clarify the Final Rule as requested herein.

Respectfully submitted,

Filed Electronically

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Dated: December 17, 2003
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CERTIFICATE OF SERVICE

Re: Amendments to Blanket Sales Certificates
Docket No. RM03-10-000

I hereby certify that I have this date served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-referenced proceeding. Copies of this document have been served upon all parties designated on the Commission's official service list, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Harrisburg, PA this 17th day of December, 2003.

Respectfully submitted,

Filed electronically

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