

I. Introduction

1. The Federal Energy Regulatory Commission (Commission) is proposing to amend the blanket certificates for unbundled gas sales services held by interstate natural gas pipelines and the blanket marketing certificates held by persons making sales for resale of gas at negotiated rates in interstate commerce to require that pipelines and all sellers for resale adhere to a code of conduct with respect to gas sales. The purpose of the proposed revisions is to ensure the integrity of the gas sales market that remains within the Commission's jurisdiction. This notice of proposed rulemaking (NOPR) is another part of the Commission's continuing effort to restore confidence in the nation's energy markets. Contemporaneously with this NOPR, the Commission is also issuing an order proposing to require sellers of electricity at market-based rates to adhere to certain behavioral rules when making sales of electricity.

II. Background

2. A decade ago, as a result of changes in the natural gas industry, Congressional legislation and various Commission rulemaking proceedings restructuring the gas industry, the Commission issued blanket certificates to allow pipelines and other persons selling natural gas to make sales for resale of natural gas at market-based or negotiated rates. These certificates were granted in two final rules issued by the Commission: Order No. 636¹ and Order No. 547.²

3. In Order No. 636, the Commission required all pipelines that provide open-access transportation to offer their sales services on an unbundled basis. To this end, the Commission issued to pipelines holding a blanket transportation certificate under subpart G of part 284 of the Commission's regulations, or performing transportation under subpart B, a blanket certificate authorizing firm and interruptible sales for resale.³ The

Commission required that all firm and interruptible sales services be provided as unbundled services under the blanket sales certificate. The Commission found that this form of regulation would enable the pipelines to compete directly with other gas sellers on the same terms at prices determined in a competitive market. The unbundled sales services were also afforded pregranted abandonment.

4. In Order No. 636, the Commission authorized pipelines to make unbundled sales at market-based rates because it concluded that, after unbundling, sellers of short-term or long-term firm gas supplies (whether they be pipelines or other sellers) will not have market power over the sale of natural gas. The Commission's determination was also based on Congress' express finding that a competitive market exists for gas at the wellhead and in the field. The Commission indicated that it was instituting light-handed regulation, relying upon market forces at the wellhead or in the field to constrain unbundled pipeline sales for resale gas prices within the Natural Gas Act's "just and reasonable" standard. In addition, the requirement that pipelines provide open access transportation from the wellhead to the market also permitted the Commission to exercise light-handed regulation over jurisdictional gas sales. Finally, the Commission stated that it would be regulating the pipeline sales in the same manner as it had done for sales for resale by marketers.

5. The Commission also determined that a pipeline as a gas merchant would be the functional equivalent of a pipeline's marketing affiliate. The Commission concluded that Order No. 497's⁴ standards of conduct would apply to the relationship between the

pipeline transportation function and its merchant function. Accordingly, the regulations issuing pipelines blanket sales certificates included standards of conduct and reporting requirements. The purpose of imposing Order No. 497's requirements was to ensure that the pipeline did not favor itself as a merchant over other gas suppliers in performing its transportation function.

6. In Order No. 547, as part of the industry restructuring begun by Order No. 636, the Commission issued blanket certificates to all persons who are not interstate pipelines authorizing them to make jurisdictional gas sales for resale at negotiated rates with pregranted abandonment.⁵ The blanket certificates were issued by operation of the rule itself and there was no requirement for persons to file applications seeking such authorization. The Commission determined that the competitive gas commodity market would lead all gas suppliers to charge rates that are sensitive to the gas sales market and cognizant of the variety of options available to gas purchasers. The Commission further stated that, in a competitive market, the basis for the rate to be negotiated between a willing buyer and seller is a commercial, not regulatory, matter. The requirement that pipelines provide open access transportation from the wellhead to the market also permitted the Commission to exercise light-handed regulation over jurisdictional gas sales. The Commission also determined that marketing certificates issued by the final rule are of a limited jurisdiction. The Commission held that the holders of marketing certificates are not subject to any other regulation under the Natural Gas Act jurisdiction of the Commission by virtue of transactions under the certificates.

III. Events in Western Energy Markets in 2000

7. In March 2003, in Docket No. PA02-2-000, the Commission Staff concluded its Fact Finding Investigation of Potential Manipulation of Electric and Gas Prices and issued a Final Report on Price Manipulation in Western Markets (Final Report). A key conclusion of the Final Report is 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 found that spot gas prices rose to extraordinary levels, facilitating the unprecedented price increase in the electricity market. The Final Report found that dysfunctions in the natural

¹ Order No. 636, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under part 284 of the Commission's regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC. Stats. & Regs. ¶ 30,939 (1992), *order on reh'g*, Order No. 636-A, FERC. Stats. & Regs. ¶ 30,950 (1992), *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *aff'd in part, rev'd in part*, *United Distribution. Cos. v. FERC*, 88 F.3d 1105 (DC Cir. 1996), *cert. denied*, 137 L. Ed. 2d 845, 117 S. Ct. 1723, 117 S. Ct. 1724 (1997), *on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *order on reh'g*, Order No. 636-D, 83 FERC ¶ 61,210 (1998).

² Regulations Governing Blanket Marketer Sales Certificates, FERC Stats. & Regs. ¶ 30,957 (1992), *order on reh'g and clarification*, 62 FERC ¶ 61,239 (1993).

³ 18 CFR 284.281-287 (2002).

⁴ Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines, Order No. 497, 53 FR 22139 (June 14, 1988), FERC Statutes and Regulations, Regulation Preambles 1986-1990 ¶ 30,820 (1988), *order on rehearing*, Order No. 497-A, 54 FR 52781 (Dec. 22, 1989), FERC Statutes and Regulations, Regulation Preambles 1986-1990 ¶ 30,868 (1989), *order extending sunset date*, Order No. 497-B, 55 FR 53291 (Dec. 28, 1990), FERC Statutes and Regulations, Regulation Preambles 1986-1990 ¶ 30,908 (1990), *order extending sunset date and amending final rule*, Order No. 497-C, 57 FR 9 (Jan. 2, 1992), FERC Statutes and Regulations ¶ 30,934 (1991), *reh'g denied*, 57 FR 5815, 58 FERC ¶ 61,139 (1992), *aff'd in part and remanded in part*, *Tenneco Gas v. Federal Energy Regulatory Commission*, 969 F.2d 1187 (DC Cir. 1992), *order on remand*, Order No. 497-D, 57 FR 58978 (Dec. 14, 1992), FERC Statutes and Regulations ¶ 30,958 (1992), *order on reh'g and extending sunset date*, Order No. 497-E, 59 FR 243 (Jan. 4, 1994), FERC Statutes and Regulations ¶ 30,987 (Dec. 23, 1994), *order on reh'g*, Order No. 497-F, 59 FR 15336 (Apr. 1, 1994), 66 FERC ¶ 61,347 (1994).

⁵ 18 CFR 284.401-402 (2002).