

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 a 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.

B. Events in Western Energy Markets

12. 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 gas market appear to stem, at least in part, from efforts to manipulate price indices compiled by trade publications. The Final Report stated that reporting of false data and wash trading are examples of efforts to manipulate published price indices.

13. While the Final Report contained numerous recommendations which will not be discussed here, the Staff did recommend that Sections 284.284 and 284.402 of the Commission's regulations be amended to provide explicit guidelines or prohibitions for trading natural gas under Commission blanket certificates. The specific recommendations include: (1) Conditioning natural gas companies' blanket certificates on providing accurate and honest information to entities that publish price indices; (2) conditioning blanket certificates on

retaining all relevant data for three years for reconstruction of price indices; (3) establishing rules banning any form of prearranged wash trading; and (4) prohibiting the reporting of trades between affiliates to industry indices.

III. Comment Analysis

A. Application of Code of Conduct to Jurisdictional Sellers

14. As an initial matter, the Commission will clarify the extent of its jurisdiction over resales of natural gas. As stated above, the Commission's NGA jurisdiction to regulate the prices charged by sellers of natural gas has been substantially narrowed by the Natural Gas Policy Act of 1978 (NGPA) and Congress' subsequent enactment of the Natural Gas Wellhead Decontrol Act of 1989. As a result of these statutory provisions first sales of natural gas were deregulated. 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.⁴ 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.

15. Therefore, the Commission's jurisdiction under the NGA includes all sales for resale by interstate and intrastate pipelines and LDCs and their affiliates, other than their sales of their own production. The Commission's jurisdiction also includes a category of sales by entities that are not affiliated

with any pipeline or LDC. Such entities are those making sales for resale of gas that was previously purchased and sold by an interstate or intrastate pipeline or LDC or retail customer.

16. Given that the Commission does not have jurisdiction over the entire natural gas market, several commenters raise concerns regarding the potential adverse effect of imposing the proposed code of conduct only on the portion of the natural gas market under the Commission's jurisdiction.⁵ Commenters assert that the proposed rules could tilt capital markets against those subject to the code of conduct because they would be viewed as a riskier proposition than those entities selling gas that do not have the same regulatory risk. Commenters argue that to impose these regulations on a portion of the market causes an uneven playing field and amounts to undue discrimination because those under the rules would be: (1) Subject to sanctions such as loss of certificate authority and disgorgement of profits; (2) hesitant to engage in legitimate transactions due to uncertainty imposed by vague and inconsistent standards developed in different proceedings; (3) subject to the increased risk of private enforcement actions by gas purchasers before the Commission; (4) subject to the shifting of investment to non-jurisdictional marketers, and; (5) subject to increased recordkeeping costs for jurisdictional entities.

17. Commenters argue that the proposed regulations are duplicative because other government agencies such as the Federal Trade Commission, the Department of Justice, and various state agencies already exercise jurisdiction over anticompetitive behavior.⁶ Further, commenters argue that in addition to stifling innovation, the proposed regulations will erode regulated marketer participation, and thereby reduce the efficiency of the markets and deprive the customers of the benefits of deregulation. Furthermore, since this code regulates only a small portion of the market,⁷ they argue that the rules will be ineffective in achieving uniform compliance.

18. Finally, commenters maintain that before imposing these potentially

⁴ NGPA Section 2(21)(A) states: 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.

⁵ See e.g., AGA, Peoples, NiSource, Nicor, Cinergy, Sempra, FPL Group, Reliant, Coral, NJR Companies, EPSA, ProLiance, Duke Energy, Questar, Western.

⁶ Coral at 5.

⁷ See NiSource at 9 (stating that the sales for resale by interstate pipelines and off-system sales by LDCs constitute a small portion of the gas sales transactions in the market, in contrast to producers and independent marketers that account for a very substantial portion of gas sold, which are not subject of the proposed regulations).