

within the Commission's established rules; (ii) do not manipulate or attempt to manipulate natural gas markets; (iii) be honest and forthright with the Commission and the institutions it has established to implement open-access transportation and entities publishing indices for the purpose of price transparency; and (iv) retain associated records. Viewed in this context, there can be no reasonable uncertainty over the underlying objectives embodied in our rules or their requirements going forward.

45. Our code of conduct rules would not supercede 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" test as required by the contract). Rather, any party seeking contract reformation or abrogation based on a violation of one or more of these regulations would be required to demonstrate that such a violation had a direct nexus to contract formation and tainted contract formation itself. If a jurisdictional seller enters into a contract without engaging in behavior that violates these regulations with respect to the formation of such contract, we do not intend to entertain contract abrogation complaints predicated on our instant code of conduct rules.

2. Wash Trades

46. Proposed Section 284.288(a)(1) 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").²⁶

47. TXU comments that wash trades should be more precisely defined, contending that the present definition does not explicitly limit the applicable transaction to one involving the same location, price, quantity, and term, and can be interpreted to prohibit legitimate exchange transactions that occur through displacement or backhauls.

48. Merrill Lynch and Morgan Stanley request that the Commission modify the definition of wash trades to clarify that it applies to parties who intended to enter into simultaneous offsetting trades to effectuate a wash trade. They request that the Commission further clarify its definition by specifying that wash trades must involve: (1) A deliberately pre-arranged pair of trades, (2) trades

made at the same time, at the same price, and at the same delivery points, and (3) trades made between the same legal entities. NGSa submits that the proposed ban on wash trades should be narrowed to encompass only simultaneous offsetting trades that are intended to manipulate market prices or rules. It explains that parties may enter into legitimate business arrangements that may appear as wash trades, for example, trades made to correct a scheduling or nomination error, or to liquidate a position at a pricing point based on subsequent changes in market conditions. NGSa suggests that the proposed regulation regarding wash trades be rewritten as: "knowingly pre-arranged simultaneous 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')."

49. Reliant recommends the definition of wash trades be refined to eliminate the possibility that multiple traders within the same company who are trading with multiple traders in another company do not stand accused of engaging in wash trades by the mere coincidence that their trades offset one another. Reliant suggests that the regulation be re-written as: "trades of the same product among the same parties, which trades are pre-arranged to be offsetting and involve no economic risk, and no net change in beneficial ownership (sometimes called 'wash trades')."

50. The Oversight Board asserts that the definition of wash trade is unduly narrow, because it limits wash trades to transactions involving the same parties, the same quantity, and no economic risk whatsoever. The Oversight Board joins NASCUA in contending the proposed definition would permit a party to evade the wash trade prescription by engaging in transactions that result in the net financial position near to, but not equal to, zero. The Oversight Board contends that the Commission should qualify its wash trade definition to ensure that the codes of conduct can effectively react to unforeseen, novel attempts to circumvent the regulatory process. The Oversight Board requests that the Commission clarify that it will define wash trades as those necessarily affecting market prices or modify the definition to include pre-arranged multi-party transactions.

51. Commenters such as Select, Duke and NEMA suggest that the Commission's definition of a "wash trade" is too broad and may encompass transactions not intended to be wash trades such as "sleeving" and

"bookout" transactions. Select explains that "sleeving" is a commonly performed trading practice in which a creditworthy party agrees to act as an intermediary in transactions between two parties who do not have a credit relationship. Duke recommends that legitimate trades may include the so-called "bookout" transactions, in which companies with offsetting delivery obligations resulting from heavy trading activity agree not to deliver to one another the offsetting amounts of energy. In the same vein, NEMA submits that there may be instances where legitimate business purposes appear to be wash trades (e.g., when traders "book out" or "test the waters"), and that the Commission should not deem such trade to be illegal. Sempra request that the wash trade prohibition to only apply to trades that affect the market and asks that the Commission clarify the definition accordingly.

52. Other commenters such as Shell Offshore, NEMA, and Coral question whether the Commission has provided adequate definitions for the terms used in its regulations. For example, Shell Offshore questions what the regulations mean by a "pre-arranged" trade, and how it differs from any other negotiation leading to a trade. It also questions how to define an "offsetting trade," and how the value is measured. It also asks what constitutes the "same product" (i.e., does an exchange of gas among the same parties constitute the same product, and thus qualify as an illegal wash trade). It also notes that there are legitimate transactions that involve "no economic risk," such as a transaction providing a guaranteed supply at a guaranteed price. NEMA also requests additional clarification of the terms "wash trades" and "pre-arranged deals" and requests that the Commission investigate the meanings of the terms "intentional manipulation" and "wash trades" as they apply to securities and commodity futures trading.

53. The Commission will adopt Section 284.288(a)(1) as proposed. Thus, the regulation will state 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").²⁷

54. The Commission disagrees with the comments that its definition of wash trades is ill conceived or vague. The

²⁶ Proposed 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 * * *."

²⁷ The Commission also adopts Section 284.403(a)(1) as proposed, which will apply the same prohibited actions and transactions to "[a]ny person making natural gas sales for resale in interstate commerce pursuant to § 284.402 * * *."