SUTHERLAND

LEGAL ALERT

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FERC Proposes Rule to Prohibit Affiliates From Coordinating Bidding in Open Seasons; Settles Allegations of Affiliate Bidding Schemes

The Federal Energy Regulatory Commission (FERC or the Commission) yesterday issued a Notice of Proposed Rulemaking (NOPR) to amend its rules to prohibit multiple affiliated companies from bidding for interstate natural gas pipeline capacity in a single open season in which the pipeline may allocate capacity on a *pro rata* basis, unless each affiliate has "an independent business reason for submitting a bid." The NOPR also would prohibit the subsequent release of any such capacity obtained pursuant to a *pro rata* allocation to any affiliate. Comments on the proposed rule will be due 45 days after publication in the Federal Register.

In two separate but related orders, FERC also approved settlements resolving two Show Cause Orders alleging the use of affiliates to "game" the *pro rata* allocation of capacity in an open season. It is clear by the timing of the proposed rule and yesterday's settlement orders that the NOPR stems from the Commission's frustrated efforts to prosecute companies for alleged schemes to "game" *pro rata* allocation mechanisms under its anti-fraud and manipulation rule. In essence, the NOPR would enable the Commission to pursue the same conduct it has attempted to prosecute as manipulation without having to prove the elements of manipulation. The NOPR also would turn what had been a single manipulative scheme into two separately punishable violations: (1) multiple affiliates bidding in a single open season and (2) the subsequent assignment of the awarded capacity. FERC's $1 million per day, per violation penalty authority applies equally to any single rule violation as to violations of FERC's anti-manipulative rule. Therefore, the NOPR would double the potential penalties for schemes FERC previously sought to prosecute as manipulation.

Proposed Rule

The Commission proposes to add new Section 284.15 to its regulations to prohibit multiple affiliates of the same entity from participating in an open season for interstate pipeline capacity offered under subparts B and G of the Commission's regulations if the pipeline may allocate capacity on a *pro rata* basis, "unless each affiliate has an independent business reason for submitting a bid." For purposes of this proposed rule, FERC will consider companies to be "affiliates" if they satisfy the definition of affiliate in Section 358.3 of its rules which is based on common control (including the rebuttable presumption that a voting interest of 10% or more constitutes control).

FERC recognizes that there may be instances in which affiliates may have independent business reasons for submitting bids in a single open season. For example, the Commission notes, "a marketing arm of an energy company may bid to secure capacity for its wholesale customers and a retail operation of the same company may bid to secure capacity to serve its retail customers." Likewise, "a marketing company may have two or more affiliates operating in different geographic areas, thus serving distinct markets all of which may be served by transportation on the same pipeline." However, FERC intends to prohibit participation by multiple affiliates in an open season where the bidding entities are not acting independently. The Commission considers it an indication that affiliates are not acting independently if a "business unit is being used by its parent or affiliate in a way that differs from its usual business operations, is used to perform transactions that an affiliate or parent could not, or is acting as an 'alter ego' of an affiliate or parent."

To further deter affiliates from coordinating bids in open seasons, FERC proposes to prohibit the assignment or other allocation of capacity for use by an affiliate. That is, if multiple affiliates participate in an open season based on their independent business reasons, the bidding affiliates are prohibited from releasing any capacity awarded in the open season to any affiliate, “or otherwise allow any affiliate effectively to obtain the use of the allocated capacity.” According to the NOPR, “[s]hould an affiliate violate the prohibition against multiple affiliate bidding, that affiliate would incur an additional violation with resulting penalties for transferring the advantage of the multiple affiliate bidding to the affiliated entity that would benefit from it.”

Settlements

On January 15, 2009, FERC directed Seminole Energy Services and four of its affiliates, and National Fuel Marketing Company LLC and three of its affiliates, to show why they should not be found to have perpetuated a fraud in connection with their bidding for, and use of, interstate natural gas transportation capacity in connection with an open season conducted by the Cheyenne Plains Natural Gas Company. On the same day, FERC also issued orders accepting settlements with multiple other companies resolve similar allegations for the same behavior.

The allegations stemmed from marketers that submitted bids on behalf of multiple affiliates to “game” the *pro rata* allocation method used by the pipeline to allocate capacity among multiple bidders. By submitting bids for multiple affiliates and then assigning the capacity to one entity, or otherwise allowing the entity to use the capacity, bidders were able to increase their share of the allocated capacity. While four groups of bidders settled the allegations, Seminole Energy and National Fuel initially refused to settle the charges.

Both Seminole Energy and National Fuel argued that the Commission had not given market participants sufficient notice that the use of multiple affiliates to bid in open seasons was prohibited. Commissioners Philip Moeller and Marc Spitzer agreed with this sentiment in dissenting statements at the time of the Show Cause Orders. However, the Commission countered that the Energy Policy Act of 2005, which authorized the Commission to prohibit fraud and manipulation, made conduct previously not prohibited now unlawful if it is manipulative. Under the settlements accepted yesterday, Seminole Energy will pay $300,000 in civil penalties and $271,315 in disgorgement, and National Fuel will pay $290,000 in civil penalties. Notably, the settlements approved two years ago resulted in substantially larger penalties: Tenaska Marketing Ventures LLC paid $3 million in civil penalties and $1.97 million in disgorgement; ONEOK Energy Service Company and its affiliates paid $4.5 million in civil penalties and $1.9 million in disgorgement; Jefferson Energy Trading Company LLC, Wizco, Inc., and Golden Stone Resources LLC paid a civil penalty of $585,000; and Klabzuba Oil & Gas FLP paid $300,000 for “attempting” to defraud despite deciding not to go through with completion of the alleged scheme.

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If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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