UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Standards of Conduct for	)	
Transmission Providers	)	Docket No. RM01-10-000

INITIAL COMMENTS OF
THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the procedures established in the Notice of Proposed Rulemaking ("NOPR") issued in the above-captioned docket on September 27, 2001[1] and the Notice of Extension of Time issued October 26, 2001,[2] the Natural Gas Supply Association ("NGSA") submits its initial comments regarding the Federal Energy Regulatory Commission's ("Commission") proposed standards of conduct for transmission providers.

I. COMMUNICATIONS AND CORRESPONDENCE.

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II. NGSA'S INTEREST IN THIS PROCEEDING.

NGSA represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the expanded use of natural gas and a regulatory climate that fosters competitive markets.

[1] 66 Fed. Reg. 50919 (October 5, 2001).
[2] 66 Fed. Reg. 55900 (November 5, 2001).

III. OVERVIEW OF THE NOPR.

Citing changes in the regulatory landscape affecting regulation of both natural gas and electricity, the Commission in the NOPR proposes to unify its treatment of the relationship between all transmission providers and affiliated energy companies, including marketers.[3] The new proposed regulations reflect two central principles:

(1) The transmission providers' employees engaged in transmission system operations must function independently from the transmission providers' sales or marketing employees and from any employees of their energy affiliates; and

(2) the transmission providers must treat all transmission customers, affiliated and non-affiliated, on a non-discriminatory basis, and cannot operate their transmission systems to benefit preferentially an energy affiliate.[4]

The new regulations attach to both "any interstate pipeline that transports gas for others" under Commission regulation and to "any public utility that owns, operates, or controls facilities used for the transmission of electric energy in interstate commerce" (other than a Commission-approved regional transmission organization ("RTO")).[5]

The NOPR proposes to advance the objective of independence through the separation of functions between employees of a transmission provider and employees of an energy affiliate.[6]

The NOPR's proposed non-discrimination requirements make transmission providers responsible to ensure that employees of energy affiliates only have access to information about the transmission provider's system that is available to all non-affiliated

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[3] Under the proposed rules, an "energy affiliate" is an affiliate of a transmission provider that (i) engages in or is involved in transmission transactions; (ii) manages or controls transmission capacity of a transmission provider; (iii) buys, sells, trades or administers natural gas or electric energy; or (iv) engages in financial transactions relating to the sale or transmission of natural gas or electric energy. Proposed 18 C.F.R. § 358.3(d)(1)-(4). The term "affiliate" refers (in the case of persons other than exempt wholesale generators) to any person who controls, is controlled by or is under common control with a transmission provider. A voting interest of 10% or more creates a rebuttable presumption of control. Proposed 18 C.F.R. § 358.3(b).

[4] Proposed 18 C.F.R. § 358.2.

[5] Proposed 18 C.F.R. § 358.1 & § 358.3(a)(1).

[6] Proposed 18 C.F.R. § 358.4.

customers.[7] Employees of a transmission provider are barred from disclosing to energy affiliates any information received from non-affiliates regarding available transmission capacity, price, curtailments, ancillary services, balancing, maintenance, capacity expansion plans or similar information relating to any transmission system, unless that information is contemporaneously made available to the public. Similarly, no information "developed in the course of responding to requests for transmission or ancillary service" may be disclosed to energy affiliates, except to the limited extent information is required to be posted electronically in response to a request for service.[8] Transmission providers are under an affirmative duty to publicly post all violations of these non-discrimination standards by their employees.

The new standards require that tariff provisions that do not permit the use of discretion must be enforced strictly. Tariff provisions that permit the use of discretion must be enforced in a fair, impartial and non-discriminatory manner. Similar requests for transmission service must be processed in the same manner and within the same period of time. Transmission providers are required to maintain a log detailing the circumstances and manner in which discretionary tariff provisions are applied, and to post this information publicly. Finally, transmission providers are precluded from granting any preference to any energy affiliate over any other wholesale customer in matters relating to the sale or purchase of transmission service.[9]

The NOPR also proposes a new standard for posting discounts:

> Any offer of a discount for any transmission service made by the transmission provider must be posted on the OASIS or Internet website contemporaneously with the offer. The posting must include: The name of the customer involved in

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[7] Proposed 18 C.F.R. § 358.5(a).
[8] Proposed 18 C.F.R. § 358.5(b).
[9] Proposed 18 C.F.R. § 358.5(c).

> the discount and whether it is an affiliate or whether an affiliate is involved in the transaction; the rate offered; the maximum rate; the time period for which the discount would apply; the quantity of power or gas scheduled to be moved; the delivery points under the transaction; and any conditions or requirements applicable to the discount.[10]

IV. NGSA HIGHLY COMMENDS THE COMMISSION'S DECISION TO IMPROVE ITS REGULATIONS GOVERNING UTILITY ENERGY AFFILIATES.

NGSA consistently has urged the Commission to re-evaluate and strengthen its regulations affecting the relationships between interstate natural gas pipelines and their energy affiliates. NGSA applauds the Commission's decision in the NOPR to enhance its oversight of those relationships. Effective regulation of the relationships between interstate pipelines and their energy affiliates promotes public and industry confidence in the natural gas industry and fosters an environment in which competition can flourish. As the Commission held in Order No. 2000, the perception that discrimination is occurring, and that market operations are not free and fair, can itself inhibit the effective development of competitive markets.

Recently, in response to the Commission's Notice of Staff Conference issued in Docket No. PL00-1-000,[11] NGSA urged the Commission to take additional steps to address pipeline affiliate relationships in the context of today's natural gas market.[12] The NOPR correctly recognizes that, in the wake of profound regulatory changes, in light of the increasing convergence of gas and power markets, and in consideration of increasing merger activity among regulated transmission providers, now is not the time to

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[10] Proposed 18 C.F.R. § 358.5(d).

[11] Notice of Staff Conference, Dialog Concerning Natural Gas Transportation Policies Needed to Facilitate Competitive Natural Gas Markets, Docket No. PL00-1-000 (November 22, 2000).

[12] Initial Comments and Request to Participate of the Natural Gas Supply Association, Dialog Concerning Natural Gas Transportation Policies Needed to Facilitate Competitive Natural Gas Markets, Docket No. PL00-1-000 (January 5, 2001).

turn back the clock on regulation of utility-energy affiliate relationships. The NOPR reflects the simple truth that ineffective regulation of utility-energy affiliate relationships can transform the Commission's open-access policies under both the Natural Gas Act and the Federal Power Act into empty promises.

V. THE NOPR REFLECTS SOUND POLICY DECISIONS. ANY PLEAS TO REVERSE COURSE IN THE NOPR SHOULD BE DISMISSED.

Throughout the debate over regulating pipeline energy affiliate relationships, opponents of reform have raised a consistent refrain. First, the argument is raised that more accidents have to occur before the Commission can even think of installing a stop sign. Yet concerns over utility energy affiliate abuses or preferences cannot be measured exclusively by the number of concrete abuses brought to the Commission for enforcement action. It is not necessary to show that a system is completely dysfunctional before it can be improved. Further, the abuses that have been detected—in cases involving NGPL, KN and Columbia—show in a clear and direct manner how the natural gas market could and would be distorted, were the Commission to abandon entirely its currently effective regulatory program. The investigations the Commission has conducted in each of these cases have disclosed patterns of alleged misconduct, covering periods sometimes measured in years and affecting hundreds of natural gas transactions. The "stop sign" created by the NOPR is warranted.

A second defense is that pipeline energy affiliate capacity holdings have not "really" changed since Order No. 497 was issued, and that the role of pipeline energy affiliates is somehow overstated. The findings in the NOPR should put to rest the argument that pipeline energy affiliate capacity holdings are not substantial: "[a] review of the data from the January 2001 Gas Index of Customers shows that

marketing/brokering affiliates hold about 18% of the affiliated pipeline capacity and non-marketing affiliates hold an additional 19% of the affiliated pipelines' capacity." The fact that affiliates (broadly defined) control 37% of capacity on their affiliate pipelines simply cannot be ignored. Further, any contention that pipeline affiliated marketers have not become substantial forces in the natural gas industry since the issuance of Order No. 497 cannot withstand even the most cursory review of pipeline annual reports to shareholders.[13]

Third, pipelines contend that current reporting requirements under Order No. 637 are so effective that no affiliate abuse could possibly escape detection. In its post-technical conference comments, NGSA showed that current reporting requirements do not effectively permit shippers to detect potential anticompetitive conduct and do not disclose certain transactions (such as capacity management deals) on a timely basis. In addition, NGSA proposed specific improvements to the Commission's data collection and oversight functions.[14]

The findings in the NOPR should put to rest the debate over whether to reform the Commission's regulation of interstate pipeline relations with energy affiliates. The NOPR appropriately recognizes that the current "marketing or brokering" definition in Part 161 of the Commission's regulations is out of phase with the present natural gas industry. As the Commission recognized in Order No. 637, pipelines can discriminate in favor of affiliated asset managers, even if they are <u>not</u> shippers of record and <u>not</u> sellers of natural gas in the particular transportation transaction at issue. Secondly, pipelines have both the opportunity and the economic incentive to share commercially sensitive

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[13] *See* NGSA Post-Technical Conference Comments, Docket No. PL00-1-000 (attached as Appendix A).
[14] Appendix A at 10-18.

third party information with affiliated generation developers as long as they are not engaged in marketing natural gas. The NOPR proposes, *inter alia*, to close these loopholes.

VI. NGSA SEEKS CLARIFICATION OF THE PROPOSED OPERATION OF SEVERAL ASPECTS OF THE NOPR.

The purpose of the clarifications sought below is to ensure that clear, objective and manageable standards are adopted in this proceeding. All segments of the energy industry are interdependent and rely on communications to ensure that natural gas gets to market. All will benefit from standards that are well-defined and straightforward to administer, to the maximum practicable extent. In several respects, the NOPR proposes to export to the natural gas industry principles and policies developed in connection with the administration of the Federal Power Act, principles with which the natural gas industry may be somewhat unfamiliar. Natural gas industry stakeholders should have a clear understanding of how the new rules will affect their operations, and of what additional steps need to be taken to ensure effective compliance with this proposed rule.

A. *Discount Policy.*

1. Review of Current Regulatory Structure.

Today, if an interstate natural gas pipeline offers a discount to an affiliate, it must offer a comparable discount contemporaneously to all similarly situated non-affiliated shippers.[15] The pipeline must post relevant information (name of the customer, maximum rate, discounted rate, delivery points and other terms and conditions) on its

[15] 18 C.F.R. § 161.3(h)(1).

website within 24 hours of the time at which gas first flows under the discount arrangement.[16]

If an interstate natural gas pipeline grants a discount to any shipper, the discount must be posted on the pipeline's web site no later than the date of the first nomination under the transaction.[17]

Pipelines can and do have direct discussions with both affiliated and non-affiliated shippers over the type, duration and nature of a discount. Pipelines are generally free to provide selective discounts as long as they do not do so in a manner found by the Commission to be unduly discriminatory.

The discounting practices of electric utilities appear to be substantially different. If electric utilities are willing to discount a given transmission path, they must communicate their willingness to discount to prospective customers only through a posting on their OASIS systems.[18] If a transmission provider offers to discount on a particular path, it must offer all customers the same discount at all unconstrained points of delivery along the same path.[19] As a result, it would appear that electric utilities effectively do not engage in selective discounting.

2. The New NOPR Standard.

In the NOPR, the Commission proposes to apply the electric discount standard to the natural gas industry. The NOPR states, in pertinent part, that:

> With the increased market transparency and liquidity the Commission proposes to adopt the electric standard for interstate natural gas pipelines, *i.e.,* that transmission providers announce all discounts (not only discounts

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[16] 18 C.F.R. § 161.3(h)(2).
[17] 18 C.F.R. § 284.13(b).
[18] 18 C.F.R. § 37.6(c)(3).
[19] Order No. 888-A, at 30,275. *Carolina Power & Light Co.,* 85 F.E.R.C. (CCH) ¶ 61,145, at 61,584 (1998).

> to affiliates) to all potential customers via the OASIS or Internet web site at the time of the offers. This is a simpler, quicker way of communicating discount information to all potential customers and ensures that all potential customers have contemporaneous equal access to current pricing information. The Commission does not propose to change the current policy permitting natural gas transmission providers to offer selective discounts.

3. Requests for Additional Guidance.

In the context of the natural gas industry, what does the phrase "at the time of the offer" mean? If a shipper requests a discount along a particular transportation path at 50% of maximum rate, it appears that a pipeline must post any response to such a solicitation. In other words, if the pipeline is willing to counter at 75% of maximum rate, that offer must be posted generally. If this interpretation were correct, however, it would appear that the proposed rule would effectively require the pipeline to offer path-specific (rather than shipper specific) discounts. In other words, there would be no private bilateral negotiation between a pipeline and a shipper if all pipeline counterproposals were deemed to be "offers" subject to posting requirements. If this interpretation were correct, however, it would not be entirely consistent with the NOPR's statement that selective discounting by natural gas pipelines is still permissible. NGSA seeks clarification regarding the application of the proposed "time of the offer" posting requirement to the natural gas industry.

NGSA also seeks confirmation that the proposed rule does not apply to shipper solicitations of discount proposals. Under the language of 18 C.F.R. § 358.5(d), it appears that any shipper (affiliated or unaffiliated) can solicit a proposal for discounted transportation from a transmission provider without having that solicitation disclosed

generally.[20] The regulation as written applies only to an offer of a discount made by the transmission provider.

Is a negotiated rate a "discount" for purposes of Proposed 18 C.F.R. § 358.5(d)? As noted above, 18 C.F.R. § 358.5(d) refers to "any offer of a discount." NGSA seeks clarification regarding the impact of the proposed regulation on negotiated rate transactions. In past decisions, the Commission has distinguished negotiated rates from discount rates. For example, in *Southern Natural Gas Co.,* 86 F.E.R.C. (CCH) ¶ 61,317 (1999), the Commission indicated that a rate would be deemed a "discounted rate" if "the agreement does not alter the pipeline's underlying rate design while keeping the adjusted rate between the maximum and minimum rates stated in the pipeline's tariff. Moreover, discounted rates do not involve the use of complex formulas, indexing, or a required minimum quantity."

If a "negotiated rate" is not a "discount" under the proposed regulation, it would appear that a pipeline could easily circumvent the earlier posting requirement established by proposed 18 C.F.R. § 358.5(d) by offering a "negotiated rate" containing (for example and not by way of limitation) a commodity rate in excess of the pipeline's maximum rate and a discounted demand component.

However, if a negotiated rate is a "discount," it would appear that the pipeline would be required to post its willingness to discount "at the time of the offer,"[21] *i.e.,* a phrase which could be read as covering a period before there is any agreement between

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[20] NGSA recognizes that selective disclosure of such a solicitation to the marketing employees of an energy company affiliated with a pipeline would be barred by proposed 18 C.F.R. § 358.5(b); however, it does not appear the general disclosure (through an Internet web posting) would be prohibited expressly.

[21] Currently, both negotiated rate and discounted firm transportation transactions are subject, *inter alia*, to the posting requirements of 18 C.F.R. § 284.13 (2001), which generally require posting within 24 hours of gas flow for transactions involving non-affiliates. In both cases, however, postings occur after the shipper and the pipeline have reached an agreement, not before.

the shipper and the pipeline. NGSA seeks clarification regarding how negotiated rates transactions are to be treated under the proposed rule.

If a pipeline offers a discount to an energy affiliate, is the pipeline still obligated to provide a contemporaneous discount to all similarly situated non-affiliates? That is the current standard expressed in 18 C.F.R. § 161.3(h)(1). However, the NOPR eliminates 18 C.F.R. Part 161 in its entirety, replacing the regulation with proposed 18 C.F.R. § 358.5(d). The new regulation is based on currently effective 18 C.F.R. § 37.6(c)(3) (the electric OASIS posting requirements). As drafted, the proposed regulation appears to substitute the electric posting requirement (18 C.F.R. § 37.6(c)(3)) for currently effective 18 C.F.R. § 161.3(h)(2) (the current affiliate discount disclosure rule), while eliminating the substantive protection provided by the contemporaneous discount requirement in its entirety.

If correct, this interpretation would be extremely problematic. As noted above, the regulatory rules applicable to electric discounts differ markedly from the selective discounts permitted under current regulation. In Order No. 888-A, the Commission found:

> [1] "[a]ny offer of a discount for transmission service made by the transmission provider must be announced solely by posting on the OASIS."
> [2] "[a]ny customer-initiated requests for discounts occur solely by posting on the OASIS, regardless of whether the customer is an own use/affiliate or a non-affiliate. Such requests must "be visible" (via posting on the OASIS) to all market participants."
> [3] "once the transmission provider and customer agree to a discounted transaction, the details (*e.g.* price, points of receipt and delivery and length of service) [must] be immediately posted on the OASIS." And,
> [4] "if the transmission provider offers a discount on a particular path, *i.e.,* from a point of receipt to a point of delivery, the transmission provider must offer the same discount for the same time period on all unconstrained paths that go the same point."

Order No. 888-A, at 30,274-275.

As the NOPR recognizes, selective discounts are permitted in the natural gas industry. Under the regulatory structure created by Order No. 888-A, however, the provision of a discount to one shipper automatically triggers an express requirement to provide the discount to all shippers along all unconstrained paths leading to the same point. No such requirement currently exists in connection with the Commission's regulation of the natural gas industry. Under current regulation, discounts offered by a pipeline to an affiliated marketer must be offered contemporaneously to all similarly situated shippers. Paradoxically, the proposed rule as drafted would permit a pipeline to offer selective discounts to an energy affiliate without limit, as long as the posting requirements were followed; however, this would be inconsistent with the obligation established by proposed 18 C.F.R. § 358.2(b) that no transmission provider "operate its transmission system to preferentially benefit an energy affiliate."

B. Information Access and Prohibited Disclosure.

Proposed Sections 358.5(a) and (b) contain broad prohibitions against the release of information by a transmission provider to an energy affiliate. Consistent with prior Commission findings in Order Nos. 497-A and 566, NGSA seeks clarification that the proposed prohibitions do not require a transmission provider to disclose information relating to an energy affiliate's specific requests for transportation service. For example, if a producer affiliated with an offshore pipeline discusses its plans for the development of new reserves and discusses its desires for transportation options, those communications would not be subject to a disclosure requirement.

In Order No. 497-A, the Commission stated (in reviewing a series of examples):

> The new line is certificated and built. Pipeline X's marketing affiliate requests transportation for a customer. Apart from the general reporting requirements of § 250.16 or other applicable rules, pipeline X would not have to disclose the information transmitted to the marketing affiliate to perfect the transportation request or to complete the transportation transaction.

The Commission reiterated this finding in Order No. 566. While both examples speak directly to communications from the pipeline to the shipper, it appears to follow both from the examples and the text of the proposed regulation that communications from the energy affiliate to the pipeline of the energy affiliate's desire(s) for transportation service or other business plans are not subject to mandatory disclosure requirements.

C. Independent Functioning of Operating Employees.

Proposed § 358.4(a) mandates that transmission function employees of a transmission provider must function independently from the employees of any energy affiliate. Employees of energy affiliates are precluded from conducting transmission system operations.

NGSA seeks clarification of these requirements. Are transmission providers precluded from having any shared employees with affiliated energy companies if the proposed rule is adopted? Can transmission providers share field employees with an energy affiliate if the shared employees do not have the ability or authority to restrict or shut down operations of the pipeline? *Compare Dominion Transmission Inc.,* 95 F.E.R.C. (CCH) ¶ 61,370 (2001)(finding that shared employees are not "operating employees" if they do not have the ability to shut down or restrict pipeline operations).

How is the proposed rule to be applied to shared directors? In electric merger cases addressing codes of conduct, the Commission has indicated that if a transmission provider shares a director with an energy affiliate, the shared director may not receive

information from non-affiliated shippers or potential non-affiliated shippers. *Dominion Transmission Inc.,* 93 F.E.R.C. (CCH) ¶ 61,284 (2000). Does the same standard apply under the Proposed Rule? If so, does this rule apply if the shared director is an employee of an "energy affiliate" that can establish that it does not "control" the regulated utility?

Can additional meaningful guidance be provided, either in the form of examples or safe harbor provisions, relating to the interpretation of when two companies will be deemed to be energy affiliates? Under the proposed regulation a rebuttable presumption of affiliation arises if a company has a 10% voting interest in a transmission provider. How may a company establish that it does not "control" an energy affiliate in which it has a 10% (or other similar small equity interest)? What factors should be cited, and how may additional guidance (or an expedited Commission ruling) be obtained?

NGSA recognizes that the Commission cannot be expected to anticipate every single situation or to address the concept of control in the abstract. Nonetheless, provision of additional guidance and direction would enable industry participants to restructure their operations promptly and efficiently, or at least to identify situations in which Commission guidance and direction should be requested.

In each of the respects noted above, additional guidance regarding the implementation of the proposed separation of function requirements would be helpful to all industry participants.

VII. NGSA'S RESPONSE TO THE NOPR's REQUEST FOR COMMENT ON ADDITIONAL POLICY CHANGES.

A. Structural Separation.

The NOPR states that "[t]he Commission is seeking comments on whether behavioral remedies for transmission providers, such as the standards of conduct or those

mentioned above, are sufficient to limit anti-competitive behavior, or whether the Commission should consider imposing structural remedies."[22] NGSA believes that structural separation (divorcement) should be used by the Commission as a regulatory last resort, if transmission providers are found to have engaged in egregious violations of Commission regulation.

B. Specific Allegations of Pipeline-Energy Affiliate Anti-Competitive Conduct.

The NOPR also request industry participants to bring to the attention of the Commission specific instances of alleged pipeline-energy affiliate conduct deemed detrimental to the development of competitive markets. In this regard, NGSA requests that the Commission take notice of the complaint filed in Docket No. RP02-99-000 by Shell Offshore Inc. against Transcontinental Gas Pipe Line and two of its energy affiliates.

In its Complaint Requesting Fast Track Processing and Request for Interim Relief, Shell Offshore Inc. ("Shell") alleges that Transcontinental Gas Pipe Line Corporation ("Transco"), in concert with its affiliates Williams Gas Processing—Gulf Coast Company, L.P. ("WGP") and Williams Field Services Company, Inc. ("WFS"), is acting in an anti-competitive manner in connection with the transportation of natural gas in interstate commerce. Shell alleges that Transco and its affiliates are implementing the abandonment of the Transco North Padre Island gathering facilities in a manner that frustrates the Commission's expectation that the abandonment would foster competition in the gathering industry and in a manner that undercuts the Commission's policies regarding open-access to the interstate transportation grid.

[22] NOPR, slip op. at 25.

While the specific allegations at issue in the Shell complaint are pending before the Commission, the issues raised in the complaint highlight once more the potential harms associated with claimed pipeline-energy affiliate misconduct. Alleged abuses such as those challenged by Shell, if left unchecked by the Commission, could act as an effective barrier to the development and delivery of OCS natural gas reserves. By imposing unreasonable obstacles to open access, by seeking exorbitant rates, and by imposing burdensome conditions on access to services subject to the jurisdiction of the Commission, interstate pipelines and their gathering affiliates can strand OCS natural gas production or bar the development of needed new supplies.

C. Current Reporting Requirements.

Current reporting requirements are helpful, but are far from adequate to curtail pipeline/energy affiliate dealings. At a bare minimum, the reporting requirements adopted in Order No. 637 must be enhanced so that industry participants can analyze reported data in a user-friendly, standardized format. Pipelines should be required to report actual usage and non-usage of scheduled capacity. Where an energy affiliate holds a large share of pipeline capacity, the following data should be required:

- ❖ The amount of capacity[23] held by others that the affiliate manages;
- ❖ The amount of capacity released from any holder of FT each month by term of release; whether the capacity is sold for more than the maximum rate; and whether it is recallable, with capacity releases by an affiliate separately identified;
- ❖ The amount of capacity released and not recalled during peak periods (*e.g.,* the consecutive three-day peak or some other measure of peak demand periods);
- ❖ The amount of secondary firm capacity at selected delivery points;
- ❖ The amount of secondary firm capacity interrupted each day, and the point(s) of interruption;
- ❖ The amount of gas sold to non-affiliates by the affiliate;
- ❖ The volume of interruptible transportation that was nominated but did not flow; and

[23] As used in this section, the term "capacity" includes mainline capacity and capacity at receipt and delivery points (particularly at points of interconnection with other interstate pipelines).

- ❖ The amount of the affiliate's primary firm transportation that was nominated and scheduled for the beginning of the day and did not flow (due to re-nomination or any other factor). This requirement is necessary to determine whether a dominant affiliate capacity holder deliberately is bumping competitor deliveries.

D. Effective Oversight Should Be Encouraged.

As NGSA has argued in the past, no reporting requirements—even those outlined above—will be effective in the absence of an effective market monitoring program. Consequently, the Commission should monitor on an ongoing basis a reasonable number of critical paths or critical receipt points on pipelines for the exercise of energy affiliate market power. This program could begin as a pilot project covering as few as 20 points and be expanded to encompass as many as 200 points, based on the experience gained through the pilot project. In addition, the Commission should devote adequate resources to frequent random audits and other appropriate market monitoring mechanisms to review pipeline/energy affiliate relationships. An effective monitoring program can act as a deterrent to anticompetitive behavior and can be a vehicle through which the Commission can let the natural gas industry know what affirmative steps are being taken to ensure that the operation of natural gas markets is free and fair.

E. Penalties for Affiliate Transgressions Must Be Swift, Sure, and Significant.

There must be appropriate and effective deterrents to abusive affiliate behavior. Penalties should be developed that are sufficient both to compensate those injured by violations of the Commission's regulations and to act as an affirmative deterrent to such violations. Even under the new rules proposed in the NOPR, affiliate transgressions will remain difficult to detect.

No amount of enlightened reform of the affiliate rules will fully constrain abuses unless the Commission sends a clear signal in this proceeding that it will not tolerate violations of its affiliate regulations. Just as importantly, the Commission must make clear to pipelines that in the event any such violations occur, the Commission will subject the pipeline to monetary penalties that are not only fully commensurate with the harm caused but that also serve as a substantial deterrent. Without the specter of such penalties, the benefits gained from illicit activity between the pipeline and its affiliate will often outweigh the sanction imposed, thus turning potential penalties into nothing more than a business risk to be factored into the consideration of a prospective pipeline/affiliate communication or commercial arrangement.

The consequences of violations must be significant enough to quell any temptation for pipelines to ignore the regulations. Only in this way will pipelines see the risk of transgressions as far outweighing the benefits. Without such an expression of intent by the Commission in the final order in this proceeding, the regulations adopted herein will not serve to address all aspects of the affiliate issue, and will not fully accomplish the Commission's goal of ensuring a competitively neutral pipeline/affiliate relationship.

VIII. CONCLUSION.

NGSA commends the Commission for taking positive steps toward establishing meaningful and effective regulation of utility-energy affiliate relationships in the NOPR. NGSA requests the additional guidance identified in these comments to ensure that all industry segments can meet the new requirements adopted in this proceeding in a timely

and effective manner. NGSA is eager to work with the Commission in the creation of monitoring and compliance mechanisms to ensure the effectiveness of this rule.

Respectfully submitted,

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