103 FERC ¶ 61, 089
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

America Electric Power Co.	Docket No. PA03-1-000
Aquila Marketing Service	Docket No. PA03-2-000
Coral Energy Resources, LP	Docket No. PA03-3-000
CMS Marketing Services & Trading	Docket No. PA03-4-000
Dynegy, Inc.	Docket No. PA03-5-000
Duke Energy Trading and Marketing, LLC	Docket No. PA03-6-000
El Paso Merchant Energy, LP	Docket No. PA03-7-000
Mirant Americas Energy Marketing, LP	Docket No. PA03-8-000
Reliant Resources, Inc.	Docket No. PA03-9-000
Sempra Energy Trading Corp.	Docket No. PA03-10-000
Williams Energy Marketing & Trading Company	Docket No. PA03-11-000

ORDER DIRECTING SUBMISSION OF INFORMATION WITH RESPECT TO INTERNAL PROCESSES FOR REPORTING TRADING DATA

(Issued April 30, 2003)

1. This order adopts company specific recommendations contained in Chapter III of Staff's Final Report on Price Manipulation in Western Markets (Docket No. PA02-2-000, issued March 26, 2003.) It directs the above-named companies to show that they have corrected their internal processes for reporting trading data to the trade press or that they no longer sell natural gas at wholesale by responding to specific questions set forth later in this order. This order is in the public interest because it will help ensure the accuracy and credibility of published price indices and that firms publishing such indices will receive complete and accurate information from the above-named companies.

BACKGROUND:

2. On August 13, 2002, the Commission released Staff's Initial Report in Docket No. PA02-2-000 with respect to manipulation in the California and Western energy markets in 2000 and 2001. In that report, among other things, Staff found significant problems

with the reliability of published price indices.[1] Staff found that due to generic problems with the price reporting process and problems specific to the California Border gas indices, many companies had the incentive and ability to manipulate the indices. After that report became public, five of the above-named companies (American Electric Power Co. (AEP), CMS Marketing Services & Trading (CMS), Dynegy, Inc. (Dynegy), El Paso Merchant Energy, LP (El Paso) and Williams Energy Marketing & Trading Company (Williams)) admitted that their employees provided false data to trade press entities that publish price indices (Platts *Gas Daily* and *Inside FERC*). El Paso's admission came in response to an October 22, 2002 data request issued in Docket No. PA02-2-000 regarding price reporting practices that was sent to a number of the largest natural gas marketers in the United States, including some of those listed in the caption of this order.

3. The October 22 data request asked a series of questions regarding the companies' past reporting practices, any internal controls they had in place, any changes they made in those procedures, and any investigations they had in progress. Staff required the companies to determine whether they had misreported trade data to trade press entities that publish price indices and to provide data on actual trades and reported data so staff could check the accuracy of those reports. In addition to issuing this data request, Staff also investigated the reporting practices of the other companies that admitted false reporting by employees (AEP, CMS, Dynegy and Williams.)

4. In the Final Report issued March 26, 2003, Staff stated that its investigation of the five companies that admitted reporting false information and its analysis of the responses to the data request revealed that the companies had few, if any, formal procedures in place to ensure the accuracy of data reported to the trade press. In some cases, there apparently were systematic efforts to bias the data reported in order to: (1) offset what was a perceived dominance of Enron Corporation's input to the process; (2) benefit a trader's own position or that of their trading desk; or (3) offset inaccuracies that traders believed other companies were reporting.[2] Staff concluded that the reporting of false data and other efforts to manipulate published price indices contributed in part to dysfunction in the natural gas market.

5. In Chapter III, entitled Manipulation of Published Natural Gas Price Indices, Staff extensively describes the reporting practices of the five companies that admitted to providing false data to the trade press and describes in detail the responses to the

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[1] Initial Report, pp. 3-5, 34, and 35-37.

[2] Final Report, p. III-3.

October 22, 2002 data request regarding reporting practices.[3] We will not repeat that detailed information here but we will note several of Staff's conclusions. First, with respect to the five companies that admitted false reporting, several common themes prevailed. Reporting was done by trading desks and the traders themselves, with little if any internal oversight by management or trading desk heads. In some cases, desk heads and management actually orchestrated the manipulation of reported prices. The false data generally was provided to achieve one of the three objectives mentioned in paragraph number 4 above. Also, traders apparently understood and tried to circumvent trade press processes designed to filter out false data by reporting phony counter parties to trades and by keeping the false data within the range of trading, but only reporting numbers that favored their trading position.[4] With respect to practices by the companies that responded to the data request, staff found that reporting practices varied, but some of the common themes applicable to the five companies that admitted supplying false information also prevailed with these companies.[5]

6. In short, Staff concluded that the traders of the five companies that admitted false reporting were deliberately attempting to manipulate the published price indices. It further concluded from the responses to its data request that attempts at price manipulation went beyond the five companies that admitted to false reporting.[6] It found an industry-wide lack of reporting procedures and internal verification processes contributed to the ability of traders to manipulate published price indices. And finally, it concluded that because many gas and electric jurisdictional transactions are based on the published indices, the Commission needs to be sure that the indices are accurate and not subject to manipulation.

7. The Final Report recognizes that there has been movement within the industry to make fundamental changes to the price reporting process. It acknowledges that most of the companies involved in natural gas trading and marketing have implemented or are in the process of implementing new procedures for reporting trading information. In many cases, the reporting function is being moved to the companies' risk management offices. Suggestions for reform and strides toward reform have come from market participants,

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[3] Id, pp. III-3 through III-28.

[4] Id, p. III-5.

[5] Id, p. III-19

[6] Id, p. III-29

risk officers, the trade publications themselves, new entrants into price reporting, government agencies, and consumer groups among others.

8. Going forward, Staff makes several recommendations for the Commission to consider to help achieve accurate and reliable price indices. Some of these recommendations relate to the characteristics that should obtain in future published price indices, conditioning of market based rate and blanket certificate authority, record retention, and standard product definitions for published indices that are not the subject of this order. Staff also notes that it has provided U.S. Attorneys' Offices with any relevant information regarding several ongoing criminal cases, and has provided other government agencies (including the Commodity Futures Trading Commission and the Securities and Exchange Commission) with information relevant to their investigations of index price reporting. Finally, as pertinent to this order, Staff urges the Commission to direct the companies identified in the caption of this order to demonstrate that they have fixed their internal processes for reporting trading data to the trade press or that they no longer sell natural gas at wholesale. Staff believes this is important because these companies are significant participants in the United States electricity and natural gas markets. Specifically, they request that the companies be directed to show the following:

> Those employees, including trading desk head and manager, who participated in manipulations or attempted manipulations of the published price indices have been disciplined.
>
> The company has a clear code of conduct in place for reporting price information.
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> All trade data reporting is done by an entity within the company that does not have a financial interest in the published index (preferably the chief risk officer).
>
> The company is cooperating fully with any government agency investigating its past price reporting practices.

DISCUSSION:

9. Staff's Final Report clearly demonstrates that the process for reporting natural gas price indices was fundamentally flawed. Traders had both the ability and incentive to manipulate the indices and they did so. What began as an investigation looking for evidence of energy price manipulation in the West produced evidence of a flawed process for publishing natural gas price indices at points throughout the United States.

10. While five companies admitted to false reporting practices, data gathered by Staff revealed conditions conducive to manipulative practices to be pervasive, going beyond those five companies. There was a system-wide lack of reporting conventions and internal controls to ensure accuracy of reported data. Because natural gas prices both directly and indirectly impact electricity prices, any flaws in the reporting of natural gas prices affects electricity prices as well.

11. This Commission has a statutory obligation to ensure the justness and reasonableness of rates for wholesale electric power, gas transportation, and the pricing mechanisms in gas pipeline tariffs (e.g., cash out provisions.) In this regard, to date, the Commission's vision has been to ensure the delivery of dependable, affordable energy through reliance on sustained competitive markets rather than through a rigid adherence to strict-cost-of service principles. The findings and conclusions of Staff's Final Report with respect to trade data reporting practices, if left unaddressed, will undermine our ability to achieve this goal. This is so because reliance on competitive markets depends on the accuracy and integrity of market price signals to do such things as allocate resources, increase supply, finance expansion, and determine the location of energy facilities among other things. Also, price indices serve as the basis for large volumes of derivative trading. Energy companies that serve consumers use such trading to hedge risk in an industry subject to inherent price volatility. Unreliable price signals can negatively impact the ability to effectively perform risk management and increase the costs of risk management. Ultimately, consumers will be hurt by the increased costs associated with the inability of energy companies to manage risk.

12. As noted in paragraph 8 above, Staff has suggested that the above-named companies, as significant participants in the natural gas and electric markets, be required to make specific demonstrations. Such demonstrations will help ensure that going forward, the information provided by these companies to publishers of price indices will be accurate and credible. This in turn will enhance the credibility of price indices and the overall health of competitive energy markets. Many of these companies have taken internal measures to correct the reporting problem, such as firing or disciplining employees who manipulated or attempted to manipulate the indices; moving the reporting responsibility away from the trading desk toward the risk management office; and having other company officers attest to the accuracy of reported data. Some have stopped wholesale sales of natural gas altogether. However staff believes the requested affirmative demonstrations are a necessary step toward rehabilitating the reliability of the price indices.

13. We concur with Staff's recommendation. Clearly, the companies' admissions and submission of information responsive to Staff's data request demonstrate past reporting

practices that lacked the standards and controls necessary to ensure that trade data provided to indices publishers was accurate and reliable. We recognize, as Staff reported, that many of these companies have taken internal, remedial measures to correct reporting problems. However, we believe the serious lack of reporting standards and controls by these jurisdictional wholesale sellers of natural gas uncovered by Staff in this investigation warrants ordering the companies to make the showings requested in paragraph 8 above. We believe this is an important step toward restoring the credibility of published indices. This required demonstration should send notice to the involved companies and the industry that we are intent on ensuring that published price indices are accurate and reliable measures of trading activity.

The Commission orders:

The companies listed in the caption to this order are directed to submit to the Commission, within 45 days of issuance of this order, written demonstrations with respect to the showings requested in paragraph 8 above.

By the Commission. Commissioner Brownell concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

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BROWNELL, Commissioner, concurring

I agree that we should ask the captioned companies to demonstrate that they have fixed their internal process for reporting trade data to the trade press or that they no longer sell natural gas at wholesale. There is no industry-wide standard for reporting conventions and internal controls. Consequently, the current practices are not the best reporting process for ensuring the accuracy and completeness of reported data. As a result, the market participants' faith in the reliability of the indices has been undermined. The lack of confidence in the indices comes at a time when the energy industry remains reliant on published price data. Restoring confidence in reported price data is essential and improvements are required.

Many of these companies have taken internal measures to correct the reporting problems, such as holding employees accountable and moving the reporting away from the trading desks. Their actions were a positive first step towards restoring faith in the indices. Our action today is another step towards bringing confidence in the accuracy of the indices to the market place. For the most part, participants at the conference on Natural Gas Price Reporting and Index Formation seemed to coalesce around the "best practices" for gas and electric price reporting that have evolved out of the efforts of the Committee of Chief Risk Officers. I believe this growing consensus, if implemented, will make significant progress towards rebuilding confidence in reported price data. I urge the industry and market participants to quickly come forward with a resolution.

The challenge I have as we work through the recommendations of the Staff's Final Report on Price Manipulation in Western Markets is that the public has the impression that high gas prices during this period were largely, if not solely, the product of price manipulation. I have asked, if everyone has known for years that people have been reporting price data in not a very responsible way, why did they continue to use the indices? Indeed, it is clear that many different factors could have influenced the indices, putting either upward or downward pressure on prices. The direction a trader will have the incentive to attempt to push prices, either higher or lower, depends upon a trader's relative positions in the financial and physical markets. The incentive at times was to offset the data reporting of others. It is also clear that for some traders the reporting of data was not necessarily for the purpose of effecting price, but to provide enough data for price formation at a point that lacks sufficient fixed-price physical deals. Reported data consisted of "surveys" that reflected the average of a range of trades that traders observed or participated in. Reported data also reflected the "sense of the market" or the trades that were observed on ICE or EOL. Many times the incentive was to increase volumes rather than prices. Furthermore, whether certain reported prices were included or excluded from the development of the index prices was at the discretion of the publisher rather than any established methodology. We can not determine the actual net effect on prices of these reporting practices and price formation. However, the argument has been made that these were sophisticated market players with multiple sources of price discovery. As such, the market continued to use the reported prices because they believed the indices generally reflected supply and demand fundamentals.

I have no doubt that the reporting practices revealed in the Staff's Final Report could have influenced the price indices in either direction and I am comfortable asking these questions as a way to achieving more accurate reporting. I want to emphasize my belief that supply and demand fundamentals were also factors causing high prices in California. The unprecedented increase in demand, no new generation in ten years, inadequate infrastructure, state regulatory policies that favored spot purchases, exceedingly abnormal weather, low hydro, and lower than normal storage inventories were reflected in higher prices and can not be ignored. As we work through the recommendations in the Staff's Final Report, I think our decisions have to be informed by the entire record.

For these reasons, I respectfully concur with this order.

Nora Mead Brownell