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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

SUPPLEMENTAL COMMENTS OF
THE NATURAL GAS SUPPLY ASSOCIATION,
THE AMERICAN PUBLIC GAS ASSOCIATION, AND
THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
IN RESPONSE TO CORPORATE GOVERNANCE CONCERNS

Over the past several months, a number of parties have submitted supplemental comments[1] in this proceeding arguing that the rules proposed in the Standards of Conduct for Transmission Providers NOPR[2] and the subsequent staff report may be in conflict with certain provisions of the Sarbanes-Oxley Act[3] requiring senior management to verify the accuracy of company financial data publicly released by the company. These parties have offered several proposals to address this issue and have also submitted requests for further technical conferences to discuss potential corporate governance solutions. The Natural Gas Supply Association (NGSA), the Independent Petroleum Association of America (IPAA), and the American Public Gas Association (APGA) (collectively, the Pipeline Customer Group) are filing these comments in response to these recent submissions and requests.

While some modifications to the current NOPR may be appropriate, overall, the vast majority of the proposed rules can go forward with no further changes. Moreover, we

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[1] INGAA filed January 13, 2003; Dominion Resources filed February 3, Duke Energy (Duke) filed March 4, 2003; Southern Company Services Inc. filed April 9, 2003 and Joint letter from AGA, EEI, and INGAA (Joint Letter) filed April 11, 2003.

[2] *Standards of Conduct for Transmission Providers,* "Notice of Proposed Rulemaking," IV FERC STATS. & REGS., Proposed Regs., ¶ 32,555 (2001)(hereinafter "NOPR").

[3] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

believe that no additional technical conferences are necessary and, perhaps most importantly, we believe that the current record forms a sufficient basis upon which the Commission can issue a final rule. Soon it will be two years since the proposed rules were issued; the Pipeline Customer Group urges the Commission to move expeditiously toward final implementation.

I. Corporate Governance Issues and Compliance with the Sarbanes-Oxley Act

The Pipeline Customer Group recognizes that companies must comply with the Sarbanes-Oxley Act as well as related Securities and Exchange Commission regulations requiring senior management to be knowledgeable as to the financial condition of both the corporation and its subsidiaries. However, we believe that minor modifications to the Commission's proposed rules can address this issue without unnecessarily delaying the promulgation of the final rule.

As a threshold matter, it is important to note that **if a holding company is not involved in energy transactions**, there is no conflict between Sarbanes-Oxley and the Commission's current NOPR as modified to reflect the April 25 Staff Analysis.[4] The April 25 Staff Analysis proposes that the final rule clarify that the definition of energy affiliate should not include holding or service companies that do not engage in or are not involved in transmission transactions in U.S. energy markets in order to allow for legitimate communications between the transmission company and the holding/service company.[5] In these cases, Commission staff suggests that the holding company be subject

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[4] The Joint Letter filed by AGA, EEI, and INGAA generally recognizes this fact by stating, "The staff-recommended exception from the definition of energy affiliate [the holding company exemption]…would not address this problem if the parent company engages in, or is involved in, any transmission transactions." *See Standards of Conduct for Transmission Providers*, Docket No. RM01-10-000, "Notice of Staff Conference and Staff Analysis of the Major Issues Raised in the Comments," issued April 25, 2002 (unpublished) (hereinafter referred to as "April 25 Staff Analysis").
[5] April 25 Staff Analysis at 7.

to the no-conduit rule.[6] The Pipeline Customer Group supports this proposal. Likewise, companies that must comply with Sarbanes-Oxley and related regulations will operate under this same exemption and will also be subject to the no-conduit rule.

Duke suggested in its March 4 filing that the holding company exemption be expanded to apply to parent companies that may not fall within the legal definition of "holding company" set forth in PUHCA. We support this modification to the extent that those parent companies are not involved in energy transactions. However, no further changes to the definition are needed.

Separate and apart from the Sarbanes-Oxley Act, holding/parent companies that include energy units are inherently problematic in that their very structure makes it nearly impossible for them to meet the goals envisioned by the Commission under its proposed Standards of Conduct.[7] This inherent structural conflict is the precise reason the Commission staff's proposed exemption for holding companies did not include those that are involved in energy transactions. How can senior management of a holding/parent company not be perceived as providing affiliate preferences when receiving transmission information from one energy affiliate and being the key decision-makers for another energy affiliate? In these instances, written procedures, along with the no-conduit rule, are simply not enough.

In general, the Commission and the parties have viewed proposals requiring major changes in the structural organization of corporations as the avenue of last resort for

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[6] *Id.* at 8.

[7] The "conflict" for holding/parent companies with energy units within the holding company was already a "problem" prior to the Sarbanes-Oxley Act in that those holding companies involved in energy transactions are captured in the definition of energy affiliate. Sarbanes-Oxley is an additional aspect of the legitimate business needs that would need to be met under the rules. To continue corporate communications between the holding company and the energy affiliate, some companies would need to reorganize their leadership roles to provide for appropriate firewalls among the various energy units.

complying with the new affiliate rules.[8] However, when corporate structures are in place that create obvious conflicts of interest, some structural changes must be implemented to eliminate the potential for affiliate preferences and/or abuses. At a minimum, separate officers and directors must be appointed within the holding/parent company and strict firewalls must be in place to limit the communications between employees who receive transmission information and employees who work for other energy affiliates. We are not asking holding companies to make corporate structural changes through some type of wholesale corporate restructuring (i.e., to create new affiliates or separate companies that may create PUHCA problems and/or issues with local PUCs). Rather, we are suggesting modest personnel changes or reorganization that effectively separate top management from shared competitive information.

As the Commission has pointed out, the Commission must balance the costs associated with separating shared functions against the benefits to competition and the need for elimination of discriminatory behavior. The Pipeline Customer Group strongly believes that the benefits of this type of separation significantly outweigh the potential costs associated with the likelihood of discrimination and the resulting adverse impact on competition.

Going forward, the Pipeline Customer Group urges FERC not to provide exemptions to those companies that adopt new corporate structures that contain energy units within the holding/parent company itself. As for those that exist today, however, with sufficient safeguards in place for a holding/parent company involved in energy transactions, we support some minor modifications to the NOPR in order for those

[8] In fact, NGSA's initial comments in this proceeding state that only when egregious violations are discovered should the Commission consider complete structural separation as a regulatory "last resort" to prevent affiliate abuse.

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companies to be in full compliance with both the Standards of Conduct Rulemaking as well as the Sarbanes-Oxley Act. A streamlined exemption, such as the one mentioned above for holding companies, could be permitted; however, each of these exemptions should be allowed only in very limited circumstances. For instance, the no-conduit rule should only apply under the holding company exemption to those persons that have good cause for receiving transmission-related information.

With respect to corporate governance communications, the central question before the Commission remains: What constitutes a sufficiently sound firewall that would allow the holding company exemption to apply to a holding/parent company that has an energy unit contained within that holding/parent company? The Pipeline Customer Group views Duke's suggested measures of assurances, such as written procedures, training and audits for employees subject to the no-conduit rule, as a good first step.[9] These rules alone, however, are not sufficient. Some level of separation of senior officers is essential to eliminate both the perception and the potential of affiliate preference. The officers of the energy units contained in a holding/parent company should be treated as a subsidiary of the holding company in all respects related to compliance with the Standards of Conduct rules.

While there are legitimate reasons for narrow exemptions from the automatic imputation rules to allow for the communication of transmission information to holding/parent companies, this should remain the exception, not the rule, for all other communications. As the Commission staff correctly points out in its April 25 Staff Paper, "The automatic imputation rule is a clearer standard and easier to implement because it

[9] NGSA's June 28, 2002 Comments suggest that employees permitted to operate under a no-conduit rule should undergo periodic training programs and sign annual affidavits attesting to compliance with the no-conduit rule. Additionally, NGSA proposed that penalties for non-compliance with the no-conduit rule should be at a level sufficient to deter abuses. (page 7).

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eliminates the opportunity for improperly sharing information." Written procedures or the no-conduit rule are simply a poor substitute for prohibition (automatic imputation) of the flow of operational data up the company decision ladder.[10] Furthermore, the gas industry is accustomed to operating under the automatic imputation rules, and any exceptions that are made to accommodate special circumstances on the electric side should NOT be applied on a generic basis to the gas side. Indeed, this would be a step backwards for the gas industry.

As with any new rule, the Commission will have to examine carefully the individual circumstances of each company impacted by the rule. In this process, we urge the Commission to balance the unique circumstances of each company with the need to ensure that the intent of the new rules remains intact. While some accommodations may be needed, we certainly do not want to see the number of exceptions effectively nullify the rule.

In summary, the Pipeline Customer Group supports:

(1) Exempting holding companies from the definition of energy affiliate, as recommended by FERC Staff.

(2) Expanding the holding company exemption to parent companies that perform the same function but are not considered "holding companies" subject to PUHCA.

(3) Extending the holding company exemption to those holding/parent companies involved in energy transactions to the extent that sufficient firewalls effectively separate the energy unit within the parent. Sufficient firewalls to permit limited use of the no-conduit rule would include:

   a. A strict compliance plan for those operating under the no-conduit rules including training, audits, and penalties; and

[10] Other measures can also be taken to mitigate the level of information that needs to be provided to senior management to make decisions at the holding/parent company level by limiting the energy affiliate's discretion to favor affiliates. For example, tariff provisions that clearly delineate procedures for the allocation of capacity or open seasons lessen the number of decisions that must be made at the top management levels.

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b. Effective separation of officers within the holding company as described above.

II. Timing Issues

The NOPR was issued on September 27, 2001. It is now more than a year and a half later, with two technical conferences and three official rounds of comments behind us. We have a full and complete record upon which the Commission may act. The rules as proposed should be adopted expeditiously so that we can finally take a solid step toward improving the affiliate rules and begin the implementation and compliance portion of this initiative.

The Commission should not allow unnecessary delays. As stated above, there are modifications that can be made to allow for compliance with Sarbanes-Oxley. Moreover, once the final rule is adopted, the Commission will then have an opportunity to evaluate the "special circumstances" during the compliance phase of this proceeding. Many of these case-specific items can and should be sorted out in the individual compliance filings.

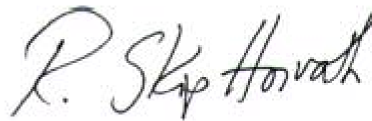
Also, the Commission should not allow the El Paso settlement to delay unnecessarily the greatly needed improvements in the affiliate rules. We understand that El Paso's actions willbe measured under the rules that were in place at the time at issue and that the industry will not measure the findings in that proceeding against any new rules that are adopted.

III. Conclusion

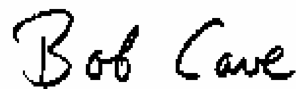
Now more than ever, expeditious adoption of improved affiliate rules is important. The corporate governance issues cited in recent pleadings can be addressed with minor modification to the proposed Standards of Conduct. In the meantime, problems continue to be uncovered at a time when the industry desperately needs to bolster its credibility.

Further delays in the adoption of a final rule only exacerbate this problem. It is time to begin the compliance phase of this initiative.

Respectfully submitted,



President
Natural Gas Supply Association



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