

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Accounting and Reporting of Financial)
Instruments, Comprehensive Income,)
Derivatives and Hedging Activities)**

Docket No. RM02-3

**COMMENTS
OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION**

In accordance with the December 20, 2001, "Notice of Proposed Rulemaking,"¹ issued in the above-referenced proceeding, the National Energy Marketers Association (NEM) respectfully submits the following comments. NEM submits that the Commission should continue to grant to energy marketers with market-based rates the waivers from Uniform System of Accounts reporting as well as Part 34 blanket approvals. The cost-based ratemaking purposes of these reporting requirements will not be advanced by their imposition on entities with market-based rates. Furthermore, imposition of these requirements on energy marketers could have negative economic impacts on energy marketers, their customers, the nascent competitive energy market and will not likely prevent future Enron-like situations. NEM also submits that FERC has not fully complied with the requirements of Executive Order 12866² and the Regulatory Flexibility Act³ by issuing this proposed rulemaking without a full cost-benefit analysis. FERC should also provide a Statement of Energy Effects for the NOPR in compliance with Executive Order 13211.⁴

The National Energy Marketers Association (NEM) is a national non-profit trade association representing a regionally diverse cross-section of wholesale and retail marketers of energy and financial products, services, information and technologies throughout the United States, Canada and the U.K. NEM's membership includes: small regional marketers, large international

1 97 FERC ¶ 61,321 (2001) [hereinafter the "NOPR"].

2 Exec. Order No. 12866, 58 Fed. Reg. 51,735 (1993).

3 5 U.S.C. § 603.

4 Exec. Order 13211, 66 Fed. Reg. 28,355 (2001).

wholesale and retail energy suppliers, billing and metering firms, Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, information technology providers as well as suppliers of advanced metering and distributed generation technology.

This regionally diverse, broad-based coalition of energy and technology firms has come together under the NEM auspices to forge consensus and to help eliminate as many issues as possible that would delay competition. NEM is committed to working with representatives of state and federal governments, large and small consumer groups and utilities to devise fair and effective ways to implement the competitive restructuring of natural gas and electricity markets. NEM and its members appear before state Public Utility Commissions, the Federal Energy Regulatory Commission and legislative bodies throughout the nation.

NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas and electricity in a competitively neutral fashion;
- Rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Standards of conduct that protect consumers;
- Policies that encourage investments in new technologies, including the integration of energy, telecommunications and Internet services to lower the cost of energy and related services; and
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives.

II. Proposed Accounting and Reporting Changes

The NOPR proposes to establish uniform accounting requirements to recognize changes in the fair market value of certain securities investments, items of other comprehensive income, derivative instruments, and hedging activities applicable to public utilities, natural gas companies, and oil pipeline companies. This is proposed to be accomplished by implementing the principles and concepts set forth in FAS 115, Accounting for Certain Investments in Debt and Equity Securities, FAS 130, Reporting Comprehensive Income, and FAS 133, Accounting for Derivative Instruments and Hedging Activities for FERC accounting and reporting purposes. The proposal

is meant to provide consistent accounting and reporting of changes in the fair value of financial investments, derivatives and hedging activities. The Commission proposes to add new balance sheet accounts to the Uniform Systems of Accounts to record items of other comprehensive income and changes in the fair value of derivative instruments. The Commission also proposes to add new general instructions for the accounting of derivative instruments and hedging activities along with new instructions for the accounting of items of other comprehensive income.

The NOPR also requested comment on the extent to which independent and affiliated power marketers and power producers should be required to follow the Uniform System of Accounts, what financial information, if any, should be reported by these entities, how frequently it should be reported, and whether these previously exempted entities should be subject to reporting the information required in the proposed regulations. Additionally, comment was sought on whether the Commission should rescind the Part 34 blanket authorizations granted to these entities and require them to comply with the Part 34 filing requirements for all future issuances of securities and assumptions of liabilities. For the reasons set forth herein, NEM urges the Commission to reaffirm its prior decisions exempting energy marketers from these requirements.

III. The Commission Should Reaffirm Prior Decisions Exempting Energy Marketers from the Proposed Accounting and Reporting Requirements

The Commission has held that energy marketers with market-based rates are "public utilities" under the terms of the Federal Power Act.⁵ The Commission has reasoned that power sales contracts constitute jurisdictional "facilities" under the Act.⁶ Notwithstanding this finding, the Commission has endeavored, "to minimize any burdens of our filing, reporting, accounting, and other requirements to the extent necessary and appropriate."⁷ The Commission has consistently waived Uniform System of Accounts requirements and has also granted blanket approval under Part 34 of FERC regulations for future issuances of securities and assumptions of liabilities.

In granting waiver of the Uniform System of Accounts in Citizens Power & Light Corp., the

5 A "public utility" is defined at 16 U.S.C. 824(e) as:

"any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter (other than facilities subject to such jurisdiction solely by reason of section 824i, 824j, or 824k of this title)."

6 Citizens Energy Corp., 35 FERC ¶ 61,197, at 61,453 (1986); Enron Power Marketing Inc., 65 FERC ¶ 61,305, at 62,405 (1993).

7 Citizens at 61,454.

Commission stated,

Parts 41, 101 and 141 prescribe certain accounting and reporting requirements that focus on the assets that a utility owns. . . . Citizens Power will not own any such assets, its jurisdictional facilities will be only corporate and documentary, its costs will be determined by utilities that sell power to it, and its earnings will not be defined and regulated in terms of an authorized return on invested capital. Therefore, the requirements in Parts 41, 101 and 141 are not relevant to this filing and waivers of these provisions will be granted.⁸

In granting waiver of Uniform System of Accounts requirements, the Commission has also considered that energy marketer transactions have, "the potential to promote a more efficient market for the sale of energy and power."⁹

NEM submits that the reasoning applied in Citizens Power continues to justify the exemption of energy marketers from Uniform System of Accounts requirements. Entities with market-based rates should not be required to comply with reporting requirements intended to aid Commission regulation of entities with cost-based rates. Such a requirement would not advance the underlying purpose of the Uniform System of Accounts.

The Commission has also granted energy marketers' requests for blanket approval under Part 34 of FERC regulations for all future issuances of securities and assumptions of liability. The Commission in Citizens Power stated that,

the purpose of section 204 of the FPA, which Part 34 implements, is to ensure the financial viability of public utilities obligated to serve electric consumers. However, Citizens Power does not intend to obligate itself to serve electric customers. Therefore, consistent with Citizens Energy and Howell Gas, Citizens Power's request for prior blanket approval for all future issuances of securities and

⁸ Citizens Power and Light Corp., 48 FERC ¶ 61,210, at 61,780 (1989).

Similarly, in Howell Gas Management Corp., the Commission reasoned,

Parts 41, 101, and 141 prescribe certain accounting and reporting requirements to ensure accuracy, consistency, and accessibility for utilities' books of account. These are regulatory provisions designed to focus on assets that a utility owns. HGM will not own or control any such assets. Like Citizens, its jurisdictional facilities are corporate or documentary in nature and its costs of electricity will be determined largely by reference to those utilities which sell power to it. Also, like Citizens, HGM's earnings will not be defined or regulated in terms of an authorized return on invested capital. These will largely be a function of the savings of the utilities which buy power from HGM. In such circumstances, the requirements of Part 41, 101 and 141 would not appear to be critical to the Commission's regulatory activities. Accordingly, these waivers will be granted. Howell Gas Management Corp., 40 FERC ¶ 61,336, at 62,025 (1987).

⁹ Howell Gas at 62,025.

assumptions of liability will be granted, subject to objection by any interested party.¹⁰

Again, NEM maintains that the Commission's reasoning for granting energy marketers blanket approval under Part 34 remain equally valid today. Energy marketers do not have the utilities' obligation to serve, and accordingly, the purpose of Part 34 would not be advanced by denying blanket approval of energy marketers' future issuances of securities and assumptions of liability.

IV. The Proposed Reporting Requirements Could Have Multiple Negative Impacts

Imposing new reporting requirements on energy marketers may cause multiple negative impacts. Estimates of the implementation costs of the reporting requirements are significant. Energy marketers will for the first time have to implement and maintain systems to capture and present information in the manner required by the Uniform System of Accounts. Energy marketers will also have to train employees to use the new systems. The reporting requirements will significantly increase the cost of doing business, discouraging entry into the competitive market and negatively impact the development and robustness of the market.

Inasmuch as the information to be reported is propriety in nature, the disclosure of such information could place energy marketers at a competitive disadvantage. The nature of information that would be reported is confidential and intrinsically linked to the energy marketers' competitive positioning. In the competitive marketplace, price is one of the chief ways to differentiate suppliers and, as such, price information is acutely sensitive. Consequently, the release of this information could be contractually problematic and can negatively impact suppliers competitive positions.

V. The Proposed Reporting Requirements May Not Yield Valuable and Relevant Information

The general goals of reporting, to provide increased access to valuable and relevant information, may not be advanced by subjecting energy marketers to cost-based reporting requirements. Inasmuch as the reporting will be performed on an after-the-fact basis, it will not reveal future issues and will not have value as an early warning measure. Also, to the extent an energy

¹⁰ Citizens Power at 61,780. See also Citizens Energy Corp. at 61,455; Howell Gas at 62,026.

marketer or any other entity is going to engage in intentional wrongdoing, the reporting requirements will not admit of such problems. Furthermore, if an energy marketer has made an ineffective hedge, it will not necessarily be revealed.

VI. The Proposed Reporting Requirements Will Not Prevent Enron-Like Failures

Furthermore, the reporting requirements should not be imposed as a reactionary measure to the Enron collapse. An obligation to report using the Uniform System of Accounts would not have prevented the Enron collapse. The Uniform System of Accounts simply is not designed to monitor the accounting and conflict issues inherent in the Enron bankruptcy. New reporting requirements should not be imposed upon the nascent energy market without a strong showing of a major public benefit at a minimum private cost. In the instant case, collecting information related to cost-based rates from market-based participants will not prevent another Enron-type scenario. Additionally, even in the wake of the Enron failure, the market worked. This was recognized by Chairman Wood in testimony before the Senate Committee on Energy and Natural Resources on January 29, 2002. In his testimony Chairman Wood stated that,

The Commission generally grants waiver of certain regulations to power marketers which receive market-based rate authorization. For example, these marketers do not need to submit cost-of-service filings because the rates they charge are market-based. The Commission also exempts power marketers from its accounting requirements, because those requirements are designed to collect the information used in setting cost-based rates. In addition, unless others object, FERC grants power marketers' requests for blanket approval for all future issuances of securities and assumptions of liability.

Because the Commission's reporting and accounting requirements are designed to address a limited set of concerns, and apply only to the jurisdictional subsidiary at issue, it is unlikely that requiring power marketers to comply with these requirements could prevent a future Enron-like failure.

NEM is also concerned that FERC's proposed imposition of these reporting requirements is not and will not be the only new regulatory or legislative proposal made to address the Enron collapse. In Enron's aftermath, this NOPR has not been the only new or increased proposed disclosure requirement. The SEC has released new suggested guidelines pertaining to liquidity, off-balance sheet arrangements, contractual obligations and commercial commitments, non-

exchange traded contracts, and related party transaction disclosures. Several bills have been introduced in Congress that would give various Commissions jurisdiction over derivatives transactions. NEM is concerned that all of these proposed rules and legislative changes should be based on a full investigation of the facts that have yet to be adduced, studied and properly analyzed.

VII. The Proposed Reporting Requirements Were Not Issued in Conformance With Executive Order 12866

Pursuant to Executive Order 12866, an agency must perform a cost-benefit analysis of a "significant regulatory action."¹¹ The term "significant regulatory action" is defined in Executive Order 12866 as:

any regulatory action that is likely to result in a rule that may:

- (1) Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;
- (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
- (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
- (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order.¹²

In the instant case, NEM submits that the proposed rule may constitute a significant regulatory action for which FERC should perform a cost-benefit analysis. The imposition of new cost-based reporting requirements on market-based participants could have an annual macroeconomic impact on the economy that requires further study under Order 12866. Also, as noted above, there is great political pressure aimed at this and other federal agencies to exercise greater oversight and require increased information disclosure and these changes must be coordinated to avoid damaging the industry and the economy.

In terms of the microeconomic impact of the NOPR, energy marketers will incur significant additional costs to develop and maintain systems to capture and present information in the manner

¹¹ Exec. Order 12866, Section 5(a)(3)(B) and (C), 58 Fed. Reg. 51,735 (1993).

¹² Exec. Order 12866, Section 3(f).

requested by FERC. FERC estimates that the total annual hours for reporting and recordkeeping will be 980 and 470 hours respectively.¹³ FERC estimates that the total annualized costs of compliance will be \$81,596.¹⁴ NEM submits that these estimates significantly understate what will be required. For instance, the estimate attributes no expense to annualized capital/startup costs. Since energy marketers have not previously been required to report this information, capital/startup costs will likely be significant.

In terms of the macroeconomic impact of the NOPR, the numerous costs of compliance that energy marketers will be forced to bear will be passed through to customers and the economy in the form of higher prices and less efficient markets. The cost and liability associated with these reporting requirements will also likely discourage new market entry further hampering the development of the competitive market and more efficient energy pricing.

NEM recommends that the NOPR be rescinded and that the agency meet with members of NEM's Risk Valuation, Management and Financial Accountability Taskforce to develop meaningful and effective measures to address the issues inherent in this rulemaking.

VIII. The Proposed Reporting Requirements Were Not Issued in Conformance With the Regulatory Flexibility Act

The Commission failed to perform a proper Regulatory Flexibility Act analysis of the NOPR. Pursuant to the Regulatory Flexibility Act, FERC must, "describe the impact of the proposed rule on small entities."¹⁵ In the instance case, the Commission stated that the NOPR will not have a significant economic impact on a substantial number of small entities.¹⁶ The Commission reasoned that, "this reporting would not be a significant burden to industry since the information is already being captured by their accounting systems and generally being reported to shareholders and others at a company, or at a consolidated business level."¹⁷ As an initial matter and contrary to the Commission's statement,¹⁸ NEM submits that many energy marketers do constitute small

13 NOPR at 33-34.

14 NOPR at 34.

15 5 U.S.C. § 603(a).

16 NOPR at 30.

17 NOPR at 31.

18 NOPR at 30-31.

entities as defined by the Small Business Act.¹⁹ As discussed herein, energy marketers have been exempted from the proposed accounting and reporting requirements. Therefore, they do not have systems or employees in place to collect and present the information in the manner requested. Consequently, imposition of these requirements on marketers would constitute a significant burden. As a result, NEM recommends that the NOPR should be rescinded and that any proposed reporting requirements be issued consistent with the requirements of the Regulatory Flexibility Act.

IX. The Proposed Reporting Requirements Were Not Issued In Conformance With Executive Order 13211

Executive Order 13211 requires that a Statement of Energy Effects be submitted by an agency to OMB pertaining to significant energy actions.²⁰ "Significant energy actions" are defined as significant regulatory actions under Executive Order 12866²¹ likely to have a significant adverse effect on energy supply, distribution and use. The Statement of Energy Effects must identify the adverse effects on energy supply, distribution or use as well as reasonable alternatives to the action.²² As discussed herein, the proposed reporting requirements do constitute a significant regulatory action under Executive Order 12866. Furthermore, imposing these requirements on energy marketers is likely to have a significant adverse effect on energy supply and use because it will have the effect of increasing energy marketers costs of doing business, thereby raising energy prices and also discouraging competitive entry. Therefore, a Statement of Energy Effects should also have been prepared with respect to the NOPR.

X. Conclusion

¹⁹ A small business entity is, "one which is independently owned and operated and which is not dominant in its field of operation." 15 USC 632 (a)(1).

²⁰ Exec. Order 13211, Section 4(b) provides that:

(b) "Significant energy action" means any action by an agency (normally published in the Federal Register) that promulgates or is expected to lead to the promulgation of a final rule or regulation, including notices of inquiry, advance notices of proposed rulemaking, and notices of proposed rulemaking:

(1)(i) that is a significant regulatory action under Executive Order 12866 or any successor order, and

(ii) is likely to have a significant adverse effect on the supply, distribution, or use of energy; or

(2) that is designated by the Administrator of the Office of Information and Regulatory Affairs as a significant energy action.

Exec. Order 13211, Section 4(b), 66 Fed. Reg. 28,355 (2001).

²¹ See Section VII supra.

²² Exec. Order 13211, Section 2(b).

NEM urges the Commission to reaffirm its prior decisions granting energy marketers with market-based rates waiver of Uniform System of Accounts and blanket approval for future issuances of securities and assumptions of liability. To do otherwise would impose substantial, unnecessary burdens on energy marketers and negatively effect the competitive market without yielding any significant benefits. Consequently, NEM urges that the NOPR be rescinded and that the agency meet with NEM's Taskforce on Risk Valuation, Management and Financial Accountability to formulate a meaningful and cost-effective response to the issues inherent in this rulemaking.

Respectfully submitted,

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Dated: March 8, 2002.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service lists compiled by the Secretary in these proceeding.

Dated at Washington, D.C.: March 8, 2002.

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