

105 FERC ¶ 61,218  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Investigation of Terms and Conditions of Public  
Utility Market-Based Rate Authorizations

Docket Nos. EL01-118-000  
and EL01-118-001

ORDER AMENDING MARKET-BASED RATE  
TARIFFS AND AUTHORIZATIONS

(Issued November 17, 2003)

1. In an order dated June 26, 2003, the Commission, acting pursuant to Section 206 of the Federal Power Act (FPA),<sup>1</sup> proposed to condition all new and existing market-based rate tariffs and authorizations on sellers' compliance with six proposed Market Behavior Rules.<sup>2</sup> The need for these Market Behavior Rules, we stated, was informed by the types of behavior that had been observed in the Western markets during 2000 and 2001; by Commission Staff's Final Report concerning these markets (Western Markets Report);<sup>3</sup> by our experience in other markets, including the organized spot markets in the East; and by the comments filed in response to our initial proposal in this proceeding.<sup>4</sup>

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<sup>1</sup> 16 U.S.C. § 824e (2000).

<sup>2</sup> See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 103 FERC ¶ 61,349 (2003) (June 26 Order). These Market Behavior Rules address: (i) unit operations; (ii) market manipulation; (iii) communications; (iv) reporting; (v) record retention; and (vi) related tariff matters.

<sup>3</sup> Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003).

<sup>4</sup> In an order issued in this proceeding on November 20, 2001, we proposed to condition all new and existing market-based rate tariffs and authorizations to include a broad prohibition against "anticompetitive behavior" and the "exercise of market power." See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 97 FERC ¶ 61,220 (2001) (Initial Order). Numerous responsive pleadings were filed in which it was asserted, among other things, that the Commission's proposed tariff provision was vague and over-broad, and that without greater specificity  
(continued...)

2. In the June 26 Order, we also stated that in formulating our proposed Market Behavior Rules, we were required to strike a careful balance among a number of competing interests. We noted, for example, that while market participants must be given an effective remedy in the event anticompetitive behavior or other market abuses occur, sellers should be provided “rules of the road” that are clearly-delineated. We noted that while regulatory certainty was important for individual market participants and the marketplace in general, the Commission must not be impaired in its ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today. We sought comments on whether our proposed rules achieved the appropriate balance among these competing interests.<sup>5</sup>

3. The vast majority of the comments we received in response supported the Commission’s overall objectives in this proceeding, *i.e.*, the need to establish clear guidelines applicable to market-based rate sellers’ conduct in the wholesale markets. In addition, we received a number of constructive suggestions for fine-tuning the specific language embodied in our proposed rules. Based on these comments and based on our further consideration of the issues discussed below, we find that sellers’ existing tariffs and authorizations, without clearly-delineated rules of the road to govern market participant conduct, are unjust and unreasonable. Without such behavioral prohibitions, the Commission will not be able to ensure that rates are the product of competitive forces and thus will remain within a zone of reasonableness. We further find that our Market Behavior Rules, as modified in Appendix A to this order, are just and reasonable and will help ensure that rates are the product of competitive forces and thus remain just and reasonable.

## **Background**

4. In the June 26 Order, we noted that as part of our ongoing responsibility to provide regulatory safeguards to ensure that customers are protected from market abuses, we were required to balance the following three goals: first, the need to provide for effective remedies on behalf of customers in the event anticompetitive behavior or other market abuses occur; second, the need to provide clearly-delineated “rules of the road” to market-based rate sellers while, at the same time, not impairing the Commission’s ability

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and guidance, our proposed tariff provision would create uncertainty in the marketplace. In the June 26 Order, we noted that our revised proposal was designed to identify more precisely and comprehensively than we had in our Initial Order the transactions and practices that would be prohibited under sellers’ market-based rate tariffs and authorizations. See June 26 Order, 103 FERC ¶ 61,349 at P6.

<sup>5</sup> June 26 Order, 103 FERC ¶ 61,349 at P7.

to provide remedies for market abuses whose precise form and nature cannot be envisioned today; and third, the need to provide reasonable bounds within which conditions on market conduct will be implemented so as not to create unlimited regulatory uncertainty for individual market participants or harm to the marketplace in general. We also noted that a stable marketplace with clearly defined rules would benefit both customers and market participants and would create an environment that will attract much-needed capital.<sup>6</sup>

5. Based on these objectives, we proposed six specific Market Behavior Rules to govern sellers' conduct in the wholesale market:

- Unit Operation: We proposed that sellers be required to operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the rules and regulations of the applicable power market;
- Market Manipulation: We proposed to prohibit all forms of market manipulation ;
- Communications: We proposed to require that sellers provide complete, accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, market monitors, regional transmission organizations (RTOs), independent system operators (ISOs), or similar entities;
- Reporting: We proposed to apply this same standard with respect to reports made by sellers to publishers of electricity or natural gas price indices;
- Record Retention: We proposed to require sellers to retain for a period of three years all data and information necessary for the reconstruction of the prices they charge, and the prices they report for use in published price indices;
- Related Tariffs: Finally, we proposed to clarify that sellers would not be permitted to violate or collude with another party in actions that violate seller's code of conduct or Order No. 889 standards of conduct.

6. We also stated that any seller found to have engaged in the behavior prohibited by our rules would be subject to a disgorgement remedy and any other appropriate non-

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<sup>6</sup> June 26 Order, 103 FERC ¶ 61,349 at P5.

monetary remedies such as revocation of seller's market-based rate authority. We sought comments from interested entities concerning a number of issues, including the specific language embodied in the rules themselves, the overall balance of interests reflected in these rules, and the remedies and procedures that would be available to market participants with respect to their enforcement.<sup>7</sup>

### **Notice and Responsive Pleadings**

7. The June 26 Order was published in the Federal Register.<sup>8</sup> Interested entities were invited to file comments within 30 days of this date, with reply comments permitted within 30 days of the comment submission date. In response, numerous comments and reply comments were received from entities representing federal and state agencies, consumer advocates, trade organizations, and all segments of the industry. These entities are listed in Appendix C to this order.

8. Comments generally supportive of the Commission's proposed rules were submitted by a broad majority of the entities who filed comments. Specifically, commenters generally concurred that establishing a clear set of market behavior standards governing sellers' conduct in the wholesale markets is necessary. There were disagreements voiced over the means to meet these objectives. For example, some argued that our proposed rules were a necessary but not a sufficient step forward in addressing the concerns outlined in the June 26 Order. These commenters submitted that in addition to our proposed rules, we should also consider a number of market design changes to bolster the overall competitiveness of the wholesale markets. Others (most notably sellers or entities representing their interests) asserted that our proposed rules would, if implemented, impose a heavy-handed, open-ended burden on sellers that would, without fine-tuning and clarification, chill investment in the industry. A number of revisions were proposed addressing these issues.

9. On July 28, 2003, Southern Company Services, Inc. (Southern) filed a request for rehearing of the June 26 Order concerning the Commission's asserted statutory authority to adopt its proposed rules.

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<sup>7</sup> In a companion issuance, we also proposed to modify natural gas market blanket certificates under subpart G of Part 284 of the Commission's regulations to contain many of the standards proposed herein, where applicable. See Notice of Proposed Rulemaking, Docket No. RM03-10-000, Amendments to Blanket Sales Certificates, 103 FERC ¶ 61,350 (2003). A Final Rule in that proceeding is being issued contemporaneously with this order.

<sup>8</sup> 68 Fed. Reg. 40,924 (2003).

## Discussion

### Procedural Matters

10. We will grant intervention status to each of the entities listed in Appendix C to this order. In addition, we will dismiss Southern's request for rehearing. As we held in the June 26 Order and reiterate here, rehearing may not be sought in this case until such time as the Commission issues a final order, *i.e.*, within 30 days of the issuance of this order.<sup>9</sup> However, we will treat Southern's rehearing request as a comment, the substance of which is addressed in Section N, below.

### Analysis

11. The task before us in this proceeding is to determine how and to what extent market-based rate seller conduct in the wholesale markets should be monitored by the Commission and, when necessary, how and to what extent this conduct should be remedied. To this end, we concur with the consensus view conveyed in the comments we have received in response to our proposed rules, namely, that sellers, while accountable for their actions, need and deserve clearly-delineated rules governing their conduct so that both sellers, buyers, and other interested entities will know what is and what is not acceptable market behavior. We find market-based rate tariffs and authorizations that do not include such standards are unjust and unreasonable.

12. Our behavioral rules are designed to provide market participants adequate opportunity to detect, and the Commission to remedy, market abuses. Our behavioral rules are also clearly defined so that they do not create uncertainty, disrupt competitive commodity markets or simply prove ineffective. However, since competitive markets are dynamic, it is important that we periodically evaluate the impact these rules have on the energy markets. We direct our office of Market Oversight and Investigation to evaluate the effectiveness and consequences of these behavioral rules on an annual basis and include this analysis in the State of the Markets Report.

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<sup>9</sup> See Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2003).

## **A. Market Behavior Rule 1 (Unit Operation)**

### **1. Commission Proposal**

13. In the June 26 Order, we noted that the integrity of an organized market and other markets as well require sellers to comply with the rules and regulations of the applicable power market. In Market Behavior Rule 1, therefore, we proposed to require that sellers operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with these rules and regulations. We stated that while market participants may become subject to additional requirements through tariff service agreements or other market participation agreements, a specific requirement in each seller's market-based rate tariff addressing unit operation issues would be necessary in order to give the Commission and interested parties direct remedial authority for violations that may not exist without such a condition.

### **2. Comments**

14. Commenters argue that Market Behavior Rule 1, unless it is revised, could be relied upon by market operators to impose operating and maintenance standards that would require generators to violate permit restrictions or operate in an unsafe manner.<sup>10</sup> EPSA, *et al.* request that the rule be modified by adding that the unit operation requirement contemplated by the rule be “consistent with the operational, legal and economic constraints on such generating facilities.”<sup>11</sup> The New York Independent System Operator, Inc. (New York ISO) characterizes this issue as a reliability concern, and proposes that the rule require sellers to inform the system operator if they are unable to follow the dispatch instructions they receive. The New York ISO also proposes that Market Behavior Rule 1 be modified to require sellers to use their “best efforts to comply with the operating instructions of the applicable power system operator.”

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<sup>10</sup> Comments of Electric Power Supply Association, Colorado Independent Energy Association, Independent Energy Producers of California, Independent Power Producers of New York, Inc. and the Western Power Trading Forum (EPSA, *et al.*) at 2. See also Comments of Exelon Corporation (Exelon) at 6; Comments of Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc. (Reliant) (“Generators should not be penalized for failure to operate a plant in a physically impossible manner or in a way that is inconsistent with economic and environmental restrictions”).

<sup>11</sup> See also Comments of Reliant at 4; Comments of Edison Electric Institute (EEI) at 8.

15. Commenters also assert that the “rules and regulations” to which the proposed rule refers should be limited to “Commission-approved” rules and regulations.<sup>12</sup> FirstEnergy asserts that absent this limitation, the rules of the applicable power market, as referenced by the proposed rule, may be unknowable and uncertain and thus, among other things, lack the procedural safeguards triggered by a Section 205 filing. Dynegy explains that ISOs, RTOs and transmission providers occasionally adopt rules, protocols, or guidelines (or interpretations of tariff provisions) without vetting them through the stakeholder process and without Commission authorization.

16. Pacific Gas and Electric Company (PG&E) submits that the term “applicable power market” also requires clarification, where there is more than one market and more than one set of rules which may apply. In addition, commenters take varying positions on the issue of whether the Commission’s proposed prohibitions should apply to bilateral and forward markets.<sup>13</sup> APPA and TAPS argue that they should, while EPSA, et al., EEI, Southern, and others assert that Market Behavior Rule 1 is inapplicable as it relates to these markets.<sup>14</sup> Southern, for example, asserts that the market abuse concerns of the type contemplated by the proposed rule do not arise in the context of arm’s-length negotiations. On this same basis, EPSA, et al. request clarification that Market Behavior Rule 1 (and indeed each of the Commission’s proposed rules) will not be a basis for modifying rates otherwise agreed to by such parties.

17. Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrill Lynch, et al.) request clarification that Market Behavior Rule 1 will not apply to marketers that do not own generation. Merrill Lynch, et al. also argue that scheduling services should not, by itself, be considered sufficient to constitute “control” of generation. Finally, the Colorado Office of Consumer Counsel<sup>15</sup> (Colorado Consumer

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<sup>12</sup> See, e.g., Comments of EEI at 8; Comments of FirstEnergy Service Company (FirstEnergy) at 6; Comments of Duke Energy Corporation (Duke) at 36; Comments of Dynegy Power Marketing, Inc., et al. (Dynegy) at 5; Comments of Edison Mission Energy at 5-6; Comments of Pinnacle West Companies (Pinnacle) at 5.

<sup>13</sup> Commenters make similar arguments as they relate to proposed Market Behavior Rule 2, discussed below.

<sup>14</sup> See, e.g., Comments of Exelon at 5; Reply Comments of Central Maine, et al. at 3.

<sup>15</sup> Joined by the New Mexico Attorney General, the Rhode Island Attorney General, the Utah Committee of Consumer Service, the Public Utility Law Project of New York, Inc., the National Consumer Law Center, and Public Citizen, Inc.

Counsel, *et al.*) interprets Market Behavior Rule 1 as a prohibition against capacity withholding and seeks clarification regarding the application of such a rule to hydroelectric generation in those parts of the country where hydro power is used primarily for peak shaving.

### 3. Commission Ruling

18. We will approve Market Behavior Rule 1, subject to two revisions, as requested. First, we will revise the rule to clarify that the “rules and regulations” to which the rule refers apply only to “Commission-approved” rules and regulations. Second, we will revise the rule to clarify that the operation of this rule will not impose a must-offer requirement on sellers (although sellers may have such an obligation independent of this rule). As revised, Market Behavior Rule 1 will require market-based rates sellers to:

*Operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.*

19. As we noted in the June 26 Order, Market Behavior Rule 1 will aid the Commission in ensuring that the rates, terms and conditions charged by market-based rate sellers remain just and reasonable by tying sellers’ conduct with respect to their unit operations to the rules and regulations of the power markets in which they do business. Our rule will thus give the Commission direct remedial authority for violations that may not exist in certain cases absent such a rule.

20. Commenters assert and we agree, however, that the rules and regulations to which this rule refers should be limited to “Commission-approved” rules and regulations of the applicable power market. We agree that it would not be appropriate to require that a market-based rate seller be made subject to potential sanction for rules or regulations (e.g., technical guidelines set forth in protocols) that have not been filed with the Commission. We also clarify that Market Behavior Rule 1, while requiring compliance with any Commission-approved rule or regulation of the applicable power market, will not otherwise apply to any bilateral power sales arrangement or other transactions to which the seller may be a party.

21. We will also revise Market Behavior Rule 1 to make clear that no “must offer” requirement will be imposed under this rule. As revised, the rule makes clear that “[c]ompliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate

Commission-approved tariff or requirement applicable to Seller.” Unless the seller is subject to a must-offer requirement pursuant to the applicability of a Commission-approved tariff, or other specific Commission-approved obligation, then, the seller will not be subject to such a requirement under our rule.<sup>16</sup> We also clarify that our rule is not intended to supersede market-specific rules such as those for outage scheduling/reporting and bidding that we have approved in our acceptance of ISO/RTO tariffs. In sum, we clarify that this rule is not intended to serve as an independent basis to impose any new obligations on sellers, or to further regulate bilateral markets.<sup>17</sup>

22. We will reject commenters’ proposed clarification that our rule apply only to market-based rate sellers who own physical generation assets. Sellers, whether they do or do not own generation, participate in markets, bid supply, and, in many cases, control generation resources through contract rights. We also clarify that to the degree physical withholding or economic withholding issues are the subject of an applicable power market’s rules and regulations, sellers’ compliance with such rules and regulations will satisfy the seller’s obligations. Thus, unless concepts of physical or economic withholding are a component of a broader manipulative behavior, as addressed in Market Behavior Rule 2, discussed below, actions taken in accord with the Commission-approved rules of an applicable power market will not be considered actionable physical or economic withholding.

23. Finally, commenters raise concerns that Market Behavior Rule 1 could require unit operation in an unsafe manner or in a way that could violate environmental permit restrictions. However, we are not aware of any Commission-approved rule or regulation (and commenters cite to no rule or regulation) which would require sellers to operate their units in an unsafe manner or in violation of any environmental permit restrictions. Issues of this nature should be raised and addressed in the applicable power markets when and to the extent they may arise.

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<sup>16</sup> To make this same point, as discussed in Section G, below, we are also rejecting our proposed Market Behavior Rule 2(e). That proposed rule, which addressed market manipulation in a specific context (*i.e.*, with respect to “bidding the output of or misrepresenting the operational capabilities of generation facilities in a manner which raises market prices by withholding available supply from the market”) was incorrectly interpreted by commenters as a must-offer requirement.

<sup>17</sup> Additional issues relating to RTO/ISO coordination matters are discussed in Section O, below.

## **B. Market Behavior Rule 2 (Market Manipulation)**

### **1. Commission Proposal**

24. In the June 26 Order, we stated that our reliance on competitive markets to establish just and reasonable rates requires that we have the tools necessary to ensure that prices created in these markets continue to fall within a just and reasonable zone. We stated that the tools we have relied upon include non-discriminatory transmission access, an efficient and pro-competitive wholesale market platform, and effective market monitoring and enforcement. Accordingly, we proposed to prohibit activities that adversely affect competitive outcomes, by stating that “[a]ctions or transactions without a legitimate business purpose which manipulate or attempt to manipulate market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand, are prohibited.”<sup>18</sup>

### **2. Comments**

25. The Electricity Consumers Resource Council<sup>19</sup> (ELCON, et al.) support Market Behavior Rule 2, as proposed. ELCON, et al. assert that the Commission’s proposed anti-manipulation prohibition is necessary due to the absence of and/or weakness of such provisions in the markets operated by the Cal ISO, PJM, ISO New England, Inc., the New York ISO and the Midwest Independent System Operator, Inc. (Midwest ISO). ELCON, et al. characterize the anti-gaming provisions currently in effect in these markets as vague and conflicting, while in other regions of the country there are no standards at all. ELCON, et al. conclude that the Commission’s proposal to apply a single anti-gaming prohibition applicable to all markets is appropriate and urgently needed.

26. Other commenters take issue with the market manipulation prohibition set forth in proposed Market Behavior Rule 2. First, commenters assert that a market manipulation prohibition should not be applied to bilateral markets. Mirant and TransAlta, for example, argue that there is no economic rationale for applying market manipulation rules outside the short-term spot markets for power, given the difficulty of exercising market power in forward markets directly or leveraging market power from short-term

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<sup>18</sup> June 26 Order, 103 FERC ¶ 61,349 at P22.

<sup>19</sup> Joined by the American Iron and Steel Institute, the American Chemistry Counsel, the American Forest & Paper Association, the Association of Business Advocating Tariff Equity, California Large Energy Consumers Association, Connecticut Industrial Energy Consumers, Industrial Energy Consumers of Pennsylvania, Southeast Electricity Consumers Association, and Multiple Intervenors.

markets into the forward markets. APPA and TAPS take the opposite position, noting market power and manipulation risks arise not only in the spot markets, but in the bilateral markets as well.

27. Commenters also challenge the sufficiency of the term “legitimate business purpose” in distinguishing between prohibited and non-prohibited conduct and question whether and to what extent the Commission can fairly (and with adequate notice to sellers) identify such motives. InterGen North America, L.P. (InterGen) argues, therefore, that the term “legitimate business purpose” is fatally vague and that there are no recognized principles or accepted rules or standards in the industry that would assist market participants in understanding what is and what is not “legitimate.” InterGen notes, in this regard, that Webster’s Dictionary defines the word “legitimate” as conforming to recognized principles or accepted rules and standards.<sup>20</sup> Dynegy Power Marketing, Inc. (Dynegy) asserts that in the organized markets in the East, any bid with respect to the marginal unit could be accused of attempting to manipulate prices, even if the market is covered by mitigation procedures that limit the unit’s bidding parameters.

28. For others, the term “legitimate business purpose” is insufficient because it will allow sellers who should be sanctioned to justify their bad conduct. The National Association of State Utility Consumer Advocates (NASUCA) points out that this term, if approved, will invite market participants to try to excuse actions that are manipulative but that were undertaken to promote some imaginable business purpose.

29. Other commenters focus their concerns on the term “legitimate forces of supply and demand.” EPSA, et al. suggest that there is little consensus as to what price might result from the unfettered interplay among these market forces because there is little consensus as to how to value scarcity, how supply and demand interact to set prices, when to allow reserves and/or demand response to set the market clearing prices, what the proper components of marginal cost are, and when mitigation is appropriate. EPSA, et al. assert that without a clearer consensus on the proper approach to price formation, the proposed term will result in a great deal of controversy and expensive litigation to address issues that would be better resolved in other forums. In addition, EPSA, et al. submit that any attempt to reconstruct the legitimate forces of supply and demand in a complex market in which the interaction of the parties affects the outcome is virtually impossible.

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<sup>20</sup> See also Comments of EEI at 10 (asserting that the term “legitimate business purpose” is vague and would, if adopted, create market uncertainty); Reply Comments of Mirant and TransAlta at 16.

30. Numerous commenters also argue that as a means of limiting the proposed rule and better defining it, an intent standard must be adopted (a recommendation also made with respect to certain other Market Behavior Rules, as discussed below).<sup>21</sup> EME argues that without intent to manipulate the proposed rule, it would be unfair to punish market participants for actions that are economically justifiable and within the bounds of these rules are properly undertaken to maximize returns in a competitive market. Southern adds that to address these concerns, Market Behavior Rule 2 should be modified to prohibit sellers from “knowingly” engaging in the conduct prohibited by the rule “with the intent” to manipulate market prices, with a “showing that the seller actually succeeded in its efforts to manipulate the market.”<sup>22</sup>

31. Reliant also argues that the term “electric energy products,” as used in the proposed rule, is undefined and otherwise unnecessary. Reliant notes the proposed rule already prohibits manipulation of market prices and that this prohibition covers prices associated with any jurisdictional product, whether energy, ancillary services, transmission, or any other.

32. The New York State Public Service Commission (New York Commission) requests that the Commission clarify that sellers are bound by the actions or transactions of their affiliates, as they relate to this rule. The New York Commission states that absent this clarification, sellers would be permitted to sidestep this rule by way of affiliate gaming practices. The New York Commission concludes that if a seller’s affiliate violates a Market Behavior Rule in a way that improperly raises market prices and the seller enters into long-term contracts that benefit from that price, the seller’s contract should be governed by this rule just as if the contracts had been signed by the affiliate.

33. Commenters also express concerns regarding the general impact of the proposed rule on the marketplace as a whole. EPSA, et al. claim that without greater specificity and clarity, the proposed rule will lead to excessive litigation. EEI speculates that sellers engaging in proscribed transactions will rely on the ambiguity in the proposed rule to

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<sup>21</sup> See, e.g., Comments of EEI at 10; Comments of EPSA, et al. at 8-12; Comments of Exelon at 6; Comments of Southern at 12; Comments of Edison Mission Energy (EME) at 6; Comments of Pinnacle West at 6; and Comments of Reliant at 6.

<sup>22</sup> Other commenters propose similar language incorporating this element of intent. See, e.g., Comments of EPSA, et al. (prohibiting actions or transactions without a legitimate purpose “and which are intended to” manipulate or attempt to manipulate market prices); Comments of Reliant at 6 (prohibiting actions or transactions “undertaken” without a legitimate business purpose “and intentionally to” manipulate market prices).

defend their bad conduct. East Texas Cooperatives and First Energy suggest that the over-breadth of the proposed rule will prohibit or at least chill legitimate business behavior. The New York ISO submits that with the uncertainty engendered by the proposed rule, higher market prices may be necessary to induce construction of new generation in New York and in other regions.

34. Finally, the Federal Trade Commission (FTC) argues that structurally competitive markets that foster ease of entry are critical to efficient pricing, output, and investment, and are more likely to protect consumers than would the proposed rule. The FTC also suggests that because there may be conflicts between antitrust law and the meaning of the terms used by the Commission in the proposed rule (e.g., the term “without a legitimate business purpose”), the Commission should limit and better focus its rule such that it would only prohibit sellers from engaging in conduct that violates the antitrust laws.

### **3. Commission Ruling**

35. We will adopt the prohibition against market manipulation, as set forth in Market Behavior Rule 2, as revised. As revised, the rule provides:

*Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule.*

36. Our rule, as revised, balances the need to provide sellers clearly-defined rules of the road while, at the same time, not impairing the Commission’s ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today. This objective is satisfied, here, by our reliance on a prohibition that is broad enough in its reach and yet clear enough in its focus to capture manipulative conduct in all its forms. Our rule, in essence, is designed to prohibit market-based rate sellers from taking actions which interfere with the prices that would otherwise be set by competitive forces, or from manipulating market conditions or market rules.<sup>23</sup> This standard, which recognizes that

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<sup>23</sup> An example of sellers’ ability to manipulate market conditions is discussed in Section C, below, relating to wash trades. An example of sellers’ ability to manipulate market rules is discussed in Section D (submission of false information) and Section E (creation of artificial congestion). An example of seller’s ability to manipulate market prices is discussed in Section F (collusive acts).

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manipulative actions engaged in by sellers are not undertaken for a legitimate business purpose, has been applied by the Commission in the past.<sup>24</sup> For the reasons discussed herein, we apply it now to all market-based rate sellers.

37. In doing so, we clarify that transactions with economic substance, in which a seller offers or provides service to a willing buyer and where value is exchanged for value, are not prohibited by our rule. While commenters question the usefulness of the term “legitimate business purpose,” in this context, we note that our reliance on this measure will ensure that sellers acting in a pro-competitive manner will have the opportunity to show that their actions were not designed to distort prices or otherwise manipulate the market. Behaviors and transactions with economic substance will thus be recognized as reflecting a legitimate business purpose consistent with just and reasonable rates.

38. However, an action or transaction which is anticompetitive (even though it may be undertaken to maximize seller’s profits), could not have a legitimate business purpose attributed to it under our rule. If, for example, a seller is shown to have caused, or attempts to cause, an artificial shortage by physically withholding sufficient and otherwise available power from the market for the purpose of raising the sales price obtainable by other units participating in the market -- the seller may be found to have engaged in market manipulation, as prescribed by Market Behavior Rule 2, *i.e.*, under these circumstances, there can be no legitimate business purpose attributable to such behavior.<sup>25</sup>

39. Our prohibition against market manipulation is not the only tool we intend to rely upon to ensure competitive markets.<sup>26</sup> It is, however, a necessary tool, because it reflects

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<sup>24</sup> See Enron Power Marketing, Inc., 103 FERC ¶ 61,343 (2003) (Enron) (revoking Enron’s blanket marketing certificate authorization based on Enron’s participation in wash trades having “no legitimate business purpose”).

<sup>25</sup> The available supply, in this instance, would have been withheld from the market without a legitimate business purpose with the objective of distorting the price of the remaining supply. Conversely, if the power was withheld due to a forced or planned outage, environmental restrictions, labor disruption, or similar business purpose, the resulting transaction would be reflective of a competitively derived price and would not be found to be manipulative. In this regard, we reject NASUCA’s concern, *i.e.*, that sellers can fabricate legitimate business purposes where there are none. In fact, the Commission is well equipped, on a case-by-case basis, to determine whether the motives ascribed to transactions by sellers are legitimate or not legitimate.

<sup>26</sup> See infra Section L.

(continued...)

the reality that we oversee a dynamic and evolving market where addressing yesterday's concerns may not address tomorrow's. As we apply Market Behavior Rule 2, moreover, we will be mindful of the fact that we are not only taking steps to assure just and reasonable rates for a specific transaction but are also providing guidance to sellers in general. As such, in determining the appropriate remedy for violations of this rule, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior.

40. As recommended by commenters, we will strike from our prohibition the proposed term that would have characterized, as manipulative behavior, an act resulting in "market prices which do not reflect the legitimate forces of supply and demand." While we do not believe that our use of this term was inappropriate or unjustified (as we intended it), many commenters appear to have misunderstood its purpose, suggesting that other causes (e.g., the lack of elasticity of demand in an organized market) may explain a given dysfunction in the interplay between supply and demand. To avoid confusion on this point, then, and because our objectives with respect to this rule can be satisfied under the surviving clause, discussed above, we have eliminated this term from our rule. We clarify, then, that our rule is not meant to say that we will identify prices that properly reflect supply and demand and then take action against sellers whose prices (however they may be established) differ. Rather, our rule is designed to prohibit market-based rate sellers from taking actions without a legitimate business purpose which intend to or foreseeably could interfere with the prices that would be set by competitive forces.<sup>27</sup>

41. We will reject commenters' argument that Market Behavior Rule 2 should identify and prohibit only expressly-defined acts of manipulation. For all the reasons discussed above, it is essential and appropriate that we have a prohibition designed to prohibit all forms of manipulative conduct. In approving such a prohibition, moreover, we take the necessary safeguards, both procedural and substantive. Thus, in the event the Commission receives a complaint about a particular behavior or identifies such behavior on its own, we will inquire into all of the surrounding facts and circumstances to understand the purpose for which the behavior was undertaken and the intended or foreseeable outcome of the behavior.

42. As a threshold matter, the Commission will evaluate if the facts presented appear to warrant further inquiry into whether the transaction appears to be of a questionable purpose. For example, actions or transactions undertaken at the direction of an ISO or an

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<sup>27</sup> The rule, then, covers actions that are intended to manipulate prices regardless of whether these actions actually accomplish their purpose. We note, however, that in most such cases, there will be no unjust profits to disgorge.

RTO are not, by definition, market manipulation in violation of our rule. In determining whether an activity is in violation of our rule, we will evaluate whether the activity was designed to lead to (or could foreseeably lead to) a distorted price not reflective of a competitive market.<sup>28</sup> If, thereafter, the market-based rate seller can establish that the behavior at issue was undertaken to provide service to a buyer with rates, terms, and conditions disciplined by the competitive forces of the market, we would find the transaction to have a legitimate business purpose and its rates to reflect a just and reasonable competitive level.

43. Our approach to the enforcement of our rules, then, will be based on a consideration of the facts and circumstances of the conduct at issue to determine its purpose and intended or foreseeable result. We recognize that manipulation of energy markets does not happen by accident. However, we also recognize that intent often must be inferred from the facts and circumstances presented. Therefore, a violation of Market Behavior Rule 2 must involve conduct which is intended to, or could foreseeably result in, distorted prices.

44. While we believe that this approach to identifying and remedying market manipulation is necessary, we also believe it is fair. We believe, for example, that sellers can recognize the difference between actions and strategies that are in furtherance of legitimate profit opportunities, or which serve important market functions, and those that result in prices that would not have been bid or paid in the absence of manipulation. We expect our enforcement and complaint procedures, as approved herein, will allow us to timely examine and fairly determine, on a case-by-case basis, when, and if, a strategy employed by a seller lacks a legitimate business purpose.

45. Moreover, while our rules will apply to all jurisdictional markets, we note these rules will not supersede or replace parties' rights under Section 206 of the FPA to file a complaint contending that a contract should be revised by the Commission (pursuant to either the "just and reasonable" or "public interest" tests as required by the contract). Rather, any party seeking contract reformation or abrogation based on a violation of one or more of the Market Behavior Rules adopted herein would be required to demonstrate that such a violation had a direct nexus to contract formation and tainted contract formation itself. If a jurisdictional seller enters into a contract without engaging in behavior that violates its tariff with respect to the formation of such contract, we do not intend to entertain contract abrogation complaints predicated on our Market Behavior Rules.

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<sup>28</sup> When deciding how best to allocate our enforcement resources, we intend to focus our efforts primarily on those actions or transactions that have, in fact, caused distorted market prices.

## C. Market Behavior Rule 2(a) (Prohibition Against Wash Trades)

### 1. Commission Proposal

46. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed to prohibit wash trades as a specific transaction that would be prohibited under our proposed rule, *i.e.*, “pre-arranged offsetting trades of the same product among the same parties, which trades involve no economic risk, and no net change in beneficial ownership.”

### 2. Comments

47. The New York ISO suggests that as an alternative to this express prohibition, the Commission should rely on the ISO (or RTO) market monitoring unit to craft and implement rules specifically tailored to address improper conduct if and as it arises.<sup>29</sup> The New York ISO also states that even if this express prohibition is adopted, the relevant aspects of the proposed rule should be incorporated into the reporting requirement embodied in Market Behavior Rule 4 (discussed below).

48. NASUCA asserts that the proposed definition of “wash trade” is too narrow, allowing sellers to evade regulation by slightly altering their transactions as they relate to price or quantity. The California Electricity Oversight Board (Cal Oversight Board) agrees, noting that by contrast, the Commodity Exchange Act defines wash trades as transactions producing “a virtual financial nullity because the resulting net financial position is near or equal to zero.”<sup>30</sup> The Cal Oversight Board further asserts that if the Commission’s wash trade prohibition is limited to the “same parties,” as proposed, the Commission would be unable to sanction transactions entered into between independent or affiliated third parties.

49. Northeast Utilities argues that the proposed rule is too broad, prohibiting sellers from engaging in legitimate “sleeve” transactions and other legitimate transactions. EEI also asserts that the proposed rule could be applied to legitimate transactions in an unfair and unjustified way. EEI states, for example, that market participants sometimes engage in product swaps between different locations to avoid the need to use physical

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<sup>29</sup> As discussed below, the New York ISO makes the same suggestion as it relates to Market Behavior Rules 2(b) and 2(c).

<sup>30</sup> Comments of the Cal Oversight Board at 10-11, citing 7 U.S.C. § 6c (2000) (emphasis added).

transmission and that these transactions are both useful and legitimate.<sup>31</sup> To exempt such transactions from the prohibitions contemplated by Market Behavior Rule 2(a), therefore, EEI suggests that the qualifying language “at the same location” be added after the phrase “pre-arranged, simultaneous, offsetting trades of the same service or product among the same parties.” In addition, Duke Energy requests clarification that “bookout” transactions, in which companies with offsetting delivery obligations resulting from heavy trading activity agree not to deliver to one another the offsetting amounts of energy, not be regarded as a prohibited wash trade.<sup>32</sup>

50. The New York ISO also identifies a transaction which it claims should not fall within the Market Behavior Rule 2(a) prohibition. The New York ISO states that when a market participant mistakenly buys instead of sells, or accidentally buys more energy or capacity than it needs, it may be required to close out of this erroneous position as quickly as possible. The New York ISO states that to do so, the market participant may wish to enter into an offsetting transaction, possibly with the same party or on the same trading platform. Such a transaction, the New York ISO contends, is legitimate and should not be prohibited.

51. To clarify what would and what would not constitute a prohibited wash trade, Merrill Lynch, et al. propose that the rule specify what they claim are the three necessary elements of a “wash trade:” (i) a deliberately pre-arranged “pair” of trades; (ii) made at the same time, for the identical price, and at the same delivery point; (iii) between the same legal entities. Reliant proposes that Market Behavior Rule 2(a) be modified to encompass “trades of the same product among the same parties, which trades are pre-arranged to be offsetting and involve no economic risk and no net change in beneficial ownership.” Finally, for the same reason as noted above, commenters propose that an intent standard be adopted as it relates to Market Behavior Rule 2(a).<sup>33</sup>

### **3. Commission Ruling**

52. We will adopt Market Behavior Rule 2(a), as proposed, to address, as a prohibited action or transaction:

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<sup>31</sup> See also Comments of Dynegy at 8.

<sup>32</sup> See also Comments of Ontario Power Generation Inc. at 4.

<sup>33</sup> See, e.g., Comments of EPSA, et al. at Att. B, p. 3; Comments of EEI at 13; Comments of Pinnacle West at 7; Merrill Lynch, et al. at 8; Comments of Duke Energy at 36; Reply Comments of ANP, et al. at 3.

*Pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades").*

53. As described in the Western Markets Report, market participants engaged in wash trading during the period 2000-01 and, as a result, distorted market liquidity as well as other indicators of market performance.<sup>34</sup> As we have noted before and reiterate here, such activity should be considered a serious violation of the authority to sell power at market-based rates. Market Behavior Rule 2(a), therefore, expressly prohibits this activity by identifying the two key elements of a wash trade, *i.e.*, transactions which are (i) prearranged to cancel each other out; and (ii) involve no economic risk.

54. EEI requests clarification that an exchange of power undertaken to avoid the procurement of a transmission service would not be considered a wash trade under our rule. We will grant EEI's request for clarification. As we understand the issue raised by EEI, the subject transactions would either be at different prices, transfer beneficial ownership, or both. As such, the exchange could not be characterized as a wash trade as we define it.

55. Commenters identify additional transactions which would not meet our definition of a wash trade and therefore would not be prohibited under Market Behavior Rule 2(a). The New York ISO's identification of trades engaged in to correct a prior error, for example, would not constitute a prohibited wash trade under our rule, because trades such as these would not be "prearranged" to cancel each other out. In addition, each of the transactions described by the New York ISO would involve economic risk because the entity attempting to correct its mistake would be at risk for any price change which could occur over the time interval between the two trades. In fact, the purpose of the off-setting trade, in this instance, would be to address the economic risk imposed by the first trade.

56. Other commenters concerns are also misplaced. We do not agree, for example, that a legitimate "sleeve" or "bookout" transaction could be characterized as a prohibited wash trade under our definition. Specifically, a sleeve is not an off-setting trade but rather a mechanism to accomplish a power sale among parties that have not established a credit relationship (involving in the transaction chain a third party seller that possesses the required creditworthiness).<sup>35</sup> Similarly, a "bookout" is not a pre-arranged trade but

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<sup>34</sup> Western Markets Report at VI-1.

<sup>35</sup> The two resulting sales (which are only offsetting to the "sleeving" seller) are each with economic risk, with a change in beneficial ownership and, usually, at slightly different prices to reflect the use of the "sleeving" sellers' credit.

rather a subsequent arrangement to financially close out a trade that was not prearranged and was undertaken (and, in fact, closed out) with economic risk.

57. In addition, while we agree with EEI, that it may be easier to undertake a wash trade that occurs at the same location, it may also be possible to engage in wash trades that involve more than one location. As such, we decline to revise our proposed rule as EEI requests.

58. Commenters also argue that Market Behavior Rule 2(a) should be revised to include an intent standard, suggesting in effect that a wash trade could be executed without intent (or without an understanding as to its consequence) and should be excused, in this instance. We disagree. Wash trades, by their very nature, are manipulative and purposely so. By definition, parties to a wash trade intend to create prearranged off-setting trades with no economic risk. Thus, we know of no legitimate business purpose attributable to such behavior and no commenter has suggested one. Accordingly, wash trades, under our rule, will constitute a per se violation of Market Behavior Rule 2.

#### **D. Market Behavior Rule 2(b) (Prohibition Against Transactions Predicated on Submission of False Information)**

##### **1. Commission Proposal**

59. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, “transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; scheduling non-firm service or products sold as firm; or conducting ‘paper trades’ where an entity falsely designates resources and fails to have those resources available and feasibly functioning).”

##### **2. Comments**

60. Commenters raise three principal concerns regarding the proposed rule: (i) its failure to include an intent standard; (ii) its apparent prohibition against virtual trading practices already permitted in organized markets; and (iii) its reference to a practice, i.e., to “paper trades,” for which, it is claimed, there is no common definition in the industry.

61. First, commenters assert that an intent standard should be adopted in order to protect sellers from the imposition of sanctions relating to inadvertent or honest errors that were not intended to manipulate market prices.<sup>36</sup> To address this issue, EPSA, et al.

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<sup>36</sup> See Comments of EPSA, et al. at Attachment B, p.3; Comments of EEI at 14;  
(continued...)

recommend that Market Behavior Rule 2(b) be revised to prohibit actions or transactions predicated on “knowingly” submitting false information to transmission providers or other entities responsible for operation of the transmission grid “with intent to manipulate the market.”<sup>37</sup>

62. Related to this same concern, Dynegy notes that due to forecasting errors, load forecasts and generation data are rarely 100 percent accurate. Dynegy further notes that sellers often face unknowable circumstances relating to the timing and duration of derates or outages. Given these and related contingencies, Dynegy seeks clarification that Market Behavior Rule 2(b) is not intended to supersede or otherwise nullify existing practices and/or market rules which allow for variation between forecasted and actual outcomes. Similarly, AES seeks clarification that the proposed prohibition does not apply to situations where submitted load data or generation data was incorrect due to the occurrence of a legitimate and verifiable contingency, or situations that occur in the normal course of business and are separately governed by terms and conditions of tariffs already on file with the Commission.

63. EEI also raises concerns regarding the interplay between the proposed rule and the existing practice known as virtual trading.<sup>38</sup> EEI proposes that the following language be incorporated into the proposed rule: “This prohibition [i.e., the prohibition set forth in Market Behavior Rule 2(b)] does not apply to transactions such as virtual trading that are an intentional part of an RTO or ISO market design.”<sup>39</sup> Finally, commenters assert that

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Comments of AES at 26-27; Comments of FirstEnergy at 9; Comments of Reliant at 10.

<sup>37</sup> EEI proposes a slight variation in this intent standard to prohibit actions or transactions “predicated on intentionally submitting false information to transmission providers including ISOs and RTOs (such as scheduling non-firm service or products sold as firm; or conducting ‘paper trades’ where an entity falsely designates resources and also fails to have those resources available and feasibly functioning).” See Comments of EEI at 14. See also Comments of Reliant at 10 (“transactions predicated on submitting information known to be false”).

<sup>38</sup> A virtual trade can be distinguished from a physical trade that is actually scheduled to the extent that it involves no actual purchase (physical acquisition) or sale (physical disposition) of electricity. It is a purely financial transaction designed to capture an arbitrage opportunity. See, e.g., PJM Interconnection, L.L.C., 104 FERC ¶ 61,39 (2003).

<sup>39</sup> The interplay between the Market Behavior Rules and virtual trading is also raised by commenters in connection with Market Behavior Rule 2(c), discussed below.

the term “paper trade” be deleted from the rule. Duke Energy claims, in this regard, that there is no common meaning in the industry for this term and thus it could refer to any number of transactions, many of which may be legitimate.

### 3. Commission Ruling

64. As discussed below, we will adopt Market Behavior Rule 2(b), subject to two revisions. As requested, we will adopt an intent standard applicable to our prohibition against the submission of false information to transmission providers or to other entities responsible for operation of the transmission grid, *i.e.*, to be actionable under this rule, the seller’s submittal must be knowingly false. Second, we will strike the example of “paper trades” from our illustrative, non-exclusive list of submissions subject to our rule. As revised, Market Behavior Rule 2(b) will prohibit:

*Transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service or products sold as firm), unless Seller exercised due diligence to prevent such occurrences.*

65. Commenters generally agree, as do we, that a Market Behavior Rule addressing market manipulation appropriately includes within its prohibitions the submission of false information to transmission providers or other entities responsible for operation of the transmission grid. As requested, however, we are approving this rule subject to the clarification that inadvertent or honest errors will not constitute a prohibited act under Market Behavior Rule 2. Rather, to be actionable under this rule, it must be shown that a seller has knowingly submitted false information.

66. This due diligence standard, however, will not be measured by the Commission with respect to the individual who actually tenders the data or who may otherwise be responsible for its submission. Rather, it will apply to the seller alone.<sup>40</sup> In this regard, we expect the seller to have in place processes that will assure the sufficiency and accuracy of the submitted information, regardless of who is actually responsible for submitting the information. Where a seller does not have such processes in place, it can be no defense to this rule that the submission of data was made by a particular individual who did not personally know it to be false or incomplete.

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<sup>40</sup> We make the same clarification, below, as it relates to Market Behavior Rules 2(d) and 3.

67. Dynegy requests clarification that Market Behavior Rule 2(b) is not intended to supersede existing market rules which allow for variation between forecasted and actual demand or generation availability. We will grant Dynegy's request. We recognize that where required, both buyers and sellers submit information to transmission providers or other entities responsible for operation of the transmission grid based on forecasts. We understand that these forecasts are not and cannot be entirely accurate. Market Behavior Rule 2 (b), as approved herein, fully accommodates this reality by addressing the knowing submission of false information. Submitting information based on good faith estimates that turn out to be incorrect, then, would not be a case of knowingly submitting false information.

68. Commenters also express concern that Market Behavior Rule 2(b) could be read to prohibit Commission-approved activities such as virtual bidding. While we do not believe that virtual bidding is premised on the knowing submission of false information, we explained in the June 26 Order,<sup>41</sup> and reiterate here, that virtual bidding and other Commission-approved activities will not be considered actions taken in violation of our Market Behavior Rules. To underscore this point expressly (and as discussed above), we have revised the prohibition set forth in Market Behavior Rule 2 to provide that “[a]ctions or transactions undertaken by Seller which are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) are not in violation of the Market Behavior Rule 2.”

69. Finally, based on commenters' objections, we have omitted the example of “paper trade” from our non-exclusive, illustrative list of submittals subject to Market Behavior Rule 2(b). We agree with Duke that because the term “paper trade” has no common meaning in the industry, at this time, using such an example to clarify the scope and reach of Market Behavior Rule 2(b) would not be beneficial.

**E. Market Behavior Rule 2(c) (Prohibition Against Transactions Relating to the Creation of Artificial Congestion Followed by the “Relief” of Such Artificial Congestion)**

**1. Commission Proposal**

70. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, “transactions in which an entity first creates artificial congestion and then ‘relieves’ such artificial congestion.”

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<sup>41</sup> June 26 Order, 103 FERC at n.18.

## 2. Comments

71. Colorado Consumer Counsel, et al. argue that, in addition to the prohibition set forth in the proposed rule, the Commission should also address how all gradations of congestion will be managed in a wholesale market context and how market power, during periods of congestion, will be constrained.

72. Reliant asserts that the Commission's apparent focus in Market Behavior Rule 2(c) is on market designs like those in California that do not use locational marginal pricing (LMP) as a tool to manage congestion. Reliant states that, if so, the Commission should clarify that its rule does not apply in LMP markets. EEI also questions the need and scope of the rule, noting that any transaction that would create "artificial congestion" would necessarily involve the submission of false information, as encompassed within the prohibition set forth in Market Behavior Rule 2(b). EEI and Pinnacle West also argue that the prohibition set forth in the rule should not apply to transactions that are consistent with an RTO's or an ISO's rules.

73. Reliant and EEI request that the Commission define what it means by "artificial congestion" because, in theory, this term could be construed to apply to (and thus be a sanction against) virtual transactions. Pinnacle West also requests clarification regarding the meaning of this term in this context.<sup>42</sup>

74. The New York ISO also claims that Market Behavior Rule 2(c) requires clarification with respect to the day-ahead and real-time markets it operates. Specifically, the New York ISO claims that the proposed rule could be interpreted to prohibit changes in day-ahead schedules in response to changes in market conditions between the day-ahead and real-time markets, i.e., to prohibit legitimate arbitrage between forward and real-time markets. Such a prohibition, it is argued, would be harmful to these markets because it would restrict market participants from responding in a competitive manner to the forces of supply and demand. The New York ISO explains that, in practice, congestion that may exist in the forward market may not exist in the real-time market, where market participants are permitted to respond competitively to these changed conditions. The New York ISO concludes that Market Behavior Rule 2(c) should be read to permit such responses in the real-time market.

75. Commenters also assert that Market Behavior Rule 2(c) should be modified to incorporate an intent standard.<sup>43</sup> EPSA, et al. recommend that the prohibition apply to

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<sup>42</sup> See also Comments of the New York ISO at 12-13.

<sup>43</sup> See Comments of EPSA, et al. at Attachment B, pp. 3-4; Comments of Reliant at 10-11.

transactions in which an entity “intends to” first create artificial congestion and then relieve such artificial congestion.<sup>44</sup>

### 3. Commission Ruling

76. We will adopt Market Behavior Rule 2(c), subject to the inclusion of an intent standard, as requested by commenters. As revised, Market Behavior Rule 2(c) will address, as a prohibited transaction:

*Transactions in which an entity creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such an occurrence).*

77. Commenters generally agree, as do we, that a Market Behavior Rule addressing market manipulation should include as an express prohibition transactions predicated on the creation and subsequent “relief” of artificial congestion. Experience has shown that in certain markets (including, in particular, markets that have not adopted an LMP market design) activities of this nature have been undertaken for the purpose of generating revenue without the occurrence of any corresponding economically substantive transaction.<sup>45</sup> Market Behavior Rule 2(c) makes clear that market manipulation of this sort, to the extent it can occur, has no legitimate business purpose and is therefore prohibited.

78. We agree with commenters, however, that Market Behavior Rule 2(c) should be revised to include an intent standard, i.e., that the prohibition set forth in this rule should be predicated on a seller having knowingly committed the prohibited conduct. As we held, above, in addressing the use of this intent standard in the context of Market Behavior Rule 2(b), however, this due diligence exception will be applied only to the entity subject to this rule, i.e., to the seller itself, not the individual acting on behalf of the seller who may have engaged in or otherwise authorized the prohibited conduct.<sup>46</sup>

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<sup>44</sup> See also Comments of Reliant at 10 (transactions in which an entity “intends first to create” artificial congestion and then “to purport to relieve” such artificial congestion); Comments of EEI at 15 (“intentionally engaging in transactions or scheduling resources that qualify for a congestion relief payment with the intent of profiting for relieving that congestion and canceling later is prohibited. This prohibition does not apply to transactions consistent with markets”).

<sup>45</sup> See Western Markets Report at VI at 26-30.

<sup>46</sup> We make this same clarification, below, as it relates to Market Behavior Rule 3.

Moreover, we will find that the seller has knowingly violated this rule where the prohibited conduct is found to have occurred in the absence of adequate internal procedures designed to prohibit its occurrence.

79. Commenters also request clarification regarding the scope and definition of the term artificial congestion, as it will be interpreted by the Commission in the context of our rule. We will grant these requests and hereby clarify that artificial congestion, under our rule, will be understood to include all forms of congestion that may result from scheduling power flows in an uneconomic manner for the purpose of creating congestion (real or perceived).

80. Finally, the New York ISO seeks clarification that the prohibition set forth in Market Behavior Rule 2(c) is not intended to be applied in those cases where a market participant may be legitimately responding to changing circumstances relative to the day-ahead and real time markets. The New York ISO points out that from time-to-time, there may be a level of congestion in the day-ahead markets that is not present in real-time markets because market participants can respond to changing conditions. The New York ISO requests clarification that such real time responses to congestion that were anticipated in the day-ahead markets will not be prohibited under our rule. We will grant the requested clarification. The market responses addressed by the New York ISO reflect appropriate behavior which is reactive to the price signals emanating from the LMP congestion management system. Market conduct of this sort will not be characterized as a prohibited act under our rule.

**F. Market Behavior Rule 2(d) (Prohibition Against Certain Collusive Acts)**

**1. Commission Proposal**

81. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we proposed, as a specific action or transaction that would be prohibited, “collusion with another party for the purpose of creating market prices at levels differing from those set by market forces.”

**2. Comments**

82. Commenters generally support a market behavior rule directed towards non-competitive collusive acts or transactions, but argue that Market Behavior Rule 2(d) should include language (and should be interpreted) consistent with federal antitrust laws

and thus not read to create new or different norms of permissible behavior.<sup>47</sup> The New York ISO agrees, noting that the antitrust laws include a significant volume of precedents dealing with the appropriate meaning and scope of such terms as “collusion” and “unlawful constraints on competition.”

83. The New York ISO also points out that Market Behavior Rule 2(d), in its proposed form, varies with federal antitrust laws in a way that it should not. Specifically, the New York ISO asserts that the term “for the purpose of creating market prices,” as used in the proposed rule, suggests a reliance on an intent standard contrary to the accepted antitrust approach to collusion. In addition, the New York ISO argues that the proposed rule’s focus on prices to the exclusion of non-price considerations is also inconsistent with federal antitrust law. Finally, the New York ISO suggests that the term “market forces,” as used in the proposed rule, departs from the antitrust term “competition” and the focus of the antitrust laws on the “unreasonable restraint of competition.”

84. The FTC also addresses these issues. The FTC points out that some seller conduct could violate both the antitrust laws and Market Behavior Rule 2, while other conduct could violate the Commission’s rule (because it may be unjust and unreasonable) but not the antitrust laws. The FTC submits that to avoid potential conflicts in policing anti-competitive behavior, the Commission should reaffirm its general rule that sellers with market-based rate authority are prohibited from engaging in conduct that would violate the antitrust laws.

### **3. Commission Ruling**

85. We will adopt Market Behavior Rule 2(d), as revised, to prohibit Sellers from engaging in:

*Collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.*

86. To avoid possible confusion regarding the interpretation and scope of the term proposed in the June 26 Order (concerning “market prices [set] at levels differing from those set by market forces), we are replacing this term with language consistent our prohibition (“manipulating market prices, market conditions, or market rules for electric energy or electricity products”). Thus, we are prohibiting market manipulation

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<sup>47</sup> See Comments of the FTC at 13; Comments of EPSA, *et al.* at Attachment B, p. 4; Comments of EMI at 7; Comments of EEI at 15; Comments of Duke Energy at 37.

undertaken by one seller acting alone and we are prohibiting market manipulation undertaken collectively.

87. As noted above, commenters, while disagreeing over the scope of our rule, generally agree that a specific market manipulation prohibition addressing collusive acts is both appropriate and necessary. EEI, for example, states that it agrees with the underlying concept embodied in the rule, while Duke concludes that the Commission's rule legitimately targets collusive activity. EPSA, moreover, as part of its code of ethics and sound trading practices, has adopted a similar standard.<sup>48</sup>

88. EEI, however, suggests that our prohibition should simply incorporate by reference existing federal antitrust law and its jurisprudence, while EPSA, et al. (reaching the same conclusion) points out that the Commission's proposed prohibition is too vague and overbroad because, among other things, there is no widespread consensus in the industry on the meaning of the term "creating market prices at levels differing from those set by market forces."

89. We disagree with these assertions. While commenters are correct in their observation that the prohibition set forth in Market Behavior Rule 2(d), as applied, may be similar in certain respects to the prohibitions set forth in federal antitrust law, specifically to the prohibitions against unreasonable restraints of trade as set forth in the Sherman Anti-Trust Act,<sup>49</sup> our authority as it relates to Market Behavior Rule 2(d) derives not from federal antitrust law, but rather from the FPA itself and its requirement that all rates and charges made, demanded, or received by any public utility subject to our jurisdiction and all rules and regulations affecting or pertaining to such rates and charges be just and reasonable. Our approach includes elements of anti-trust law but is not limited to such. For example, it also encompasses "partnerships" whose existence do not implicate anti-trust concerns.<sup>50</sup>

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<sup>48</sup> The EPSA standard prohibits parties from colluding with other market participants to affect the price or supply of power, allocate territories, customers or products, or otherwise unlawfully restrain competition.

<sup>49</sup> See 15 U.S.C. § 1 (2000).

<sup>50</sup> See Enron Power Marketing, Inc., et al., 103 FERC ¶ 61,346 (2003) (Enron Partnerships Order) (requiring Enron and other entities with whom it had partnerships or other arrangements to show cause why they should not be found to have jointly engaged in manipulation schemes).

90. Thus, we need not address, here, whether or to what extent federal antitrust law may be broader in scope, in certain instances, or more narrow in scope, in other cases. Federal antitrust law, rather, will apply to sellers in the judicial proceedings or other authorized settings in which it is found to apply. Our rule, on the other hand, will be governed by the unique facts and circumstances at play in the wholesale electric industry and will be interpreted by the Commission consistent with our statutory duties relating to these issues.<sup>51</sup>

91. We also disagree that the Commission's standard is vague and overbroad and thus will not give sellers adequate notice of the conduct it requires or prohibits. While we address commenters' due process challenges in greater detail in Section N, below, we note here, with respect to Market Behavior Rule 2(d) in particular, that our rule merely expands upon the prohibition against market manipulation set forth in Market Behavior Rule 2. As discussed above, moreover, this prohibition is limited to actions or transactions that do not have a legitimate business purpose. As such, a seller cannot be found to have violated the prohibition set forth in Market Behavior Rule 2(d) where the conduct at issue (as known to the seller itself, in the first instance) has a legitimate business purpose. This limitation, we believe, puts sellers on adequate notice regarding the scope of our rule.

92. Finally, we do not agree that the industry lacks an understanding regarding the meaning of the terms referred to in our rule. These terms, rather, have more than a mere hypothetical or theoretical existence, as our recent experience relating to collusion in the Western markets aptly demonstrates.<sup>52</sup>

## **G. Market Behavior Rule 2(e) (Prohibition Against Certain Bidding Behavior).**

### **1. Commission Proposal**

93. In addition to the prohibition against market manipulation, as set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, "bidding the output of or misrepresenting the operational capabilities of

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<sup>51</sup> See, e.g., *Pennsylvania Water & Power Co. v. FPC*, 193 F.2d 230, 236 (D.C. Cir. 1951) ("A rate is not necessarily illegal because it is the result of a conspiracy in restraint of trade in violation of the Anti-Trust Act. What rates are legal is determined by the regulatory statute." [cit. omit.]).

<sup>52</sup> See Enron Partnerships Order, 103 FERC at P46.

generation facilities in a manner which raises market prices by withholding available supply from the market.”

## 2. Comments

94. Commenters challenge Market Behavior Rule 2(e) on a number of grounds. As a legal matter, EEI and others assert that the proposed rule is vague and overbroad, thus failing to provide market participants with sufficient notice of the conduct it would require or prohibit.<sup>53</sup> The New York ISO adds that the proposed rule fails to make any distinction between competitive and anti-competitive behavior or set a threshold that would permit market participants to have reasonable flexibility to adjust their bidding behavior in conformance with legitimate market forces. AES asserts that the proposed rule is vulnerable to misinterpretation and would require substantial oversight on the part of regulators.

95. Commenters also argue that the rule, if implemented, should adopt an intent standard, among other revisions. Reliant argues that inadvertent misrepresentations should not be considered violations of the rule and should not subject a seller to the same penalties that would attach to intentional violations. FirstEnergy adds that a seller should not be penalized for the types of action prohibited by the rule absent a showing that the actions at issue were intended to raise market prices above competitive levels.

96. Commenters also address whether and to what extent the proposed rule should define and more squarely address the concepts of physical withholding and economic withholding on an industry-wide basis.<sup>54</sup> Reliant asserts that its proposed definition of physical withholding would include an intent requirement and, with respect to subsection (b), would note that there may be legitimate reasons for not complying with a must-offer requirement.<sup>55</sup> EPSA, *et al.* add that the Commission’s rule against physical withholding should include safe harbor language that would not require sellers to run their units in

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<sup>53</sup> See Comments of EEI at 17; Comments of Southern at 14; Comments of InterGen at 15; Comments of Reliant at 11.

<sup>54</sup> Reliant proposes that the rule be revised to adopt the following standard relating to physical withholding: Entities may not physically withhold the output of an Electric Facility (Generating unit or Transmission Facility) by (a) intentionally falsely declaring that an Electric Facility has been forced out of service or otherwise become unavailable, or (b) intentionally failing to comply with any applicable must-offer conditions of a participating generator agreement.

<sup>55</sup> See also Comments of EEI at 16-17 (noting that generating capacity may be withheld from the market for reasons not associated with anti-competitive activity).

certain specified circumstances (e.g., when doing so would risk jeopardizing public health and safety or damaging the seller's facilities, in order to comply with facility licensing, environmental or other legal requirements; or when doing so would be uneconomic under the given circumstances).

97. Commenters also raise a number of concerns regarding the definition and scope of the term economic withholding, as it might be applied by the Commission under its proposed Market Behavior Rule 2(e) standard. The New York ISO asserts that any prohibition on withholding supply from the market should not be triggered by the inclusion of legitimate opportunity costs in a unit's bid. Reliant, on the other hand, asserts that defining what would and what would not constitute withholding under the proposed rule is virtually undoable.

98. Finally, EEI asserts that because Market Behavior Rule 1 and Market Behavior Rule 2(b) require sellers to operate their generation units consistent with RTO and ISO rules and prohibit the submission of false information, Market Behavior Rule 2(e) is redundant and unnecessary. The New York ISO claims that the prohibitions contemplated by the rule could be implemented by existing market mitigation measures approved by the Commission.

### **3. Commission Ruling**

99. We agree with commenters that Market Behavior Rule 2(e) is redundant and unnecessary and therefore will not adopt it. For the reasons discussed below, we find that Market Behavior Rule 1 sufficiently addresses the concerns we intended to address in proposing the express prohibition embodied in Market Behavior Rule 2(e).

100. Several commenters appear to have misread the intent of our proposed rule. They suggest that, if implemented, the proposed rule would have imposed a must-offer condition in markets in which such a requirement is not currently in effect. However, we did not intend to create this or any other new substantive obligation applicable to sellers, *i.e.*, obligations other than those which already apply to sellers in the markets in which they operate. Our intent, rather, was simply to provide clarity regarding a specific form of market manipulation that would, as proposed, be expressly prohibited under Market Behavior Rule 2.

101. Because our proposed rule related to "bidding" into organized markets and to misrepresentations concerning the "operational capabilities of generation facilities," commenters are correct that the requirements addressed by our proposed rule were necessarily tied to the existing requirements of the applicable power markets in which sellers operate and thus were already addressed by the unit operation requirements addressed in Market Behavior Rule 1. Given this overlap, *i.e.*, this redundancy in our

proposed rules, we agree with those commenters who assert that Market Behavior Rule 2(e), as proposed, is unnecessary and should be rejected.

102. In reaching this conclusion, however, we are not finding that physical withholding,<sup>56</sup> or economic withholding,<sup>57</sup> cannot be a component of an activity that constitutes market manipulation, as prescribed by Market Behavior Rule 2.<sup>58</sup> Nonetheless, we clarify here that seller's compliance with Market Behavior Rule 1, *i.e.*, with the Commission-approved bidding and outage reporting rules in organized markets, should be sufficient to meet a sellers' obligations concerning bidding and reporting requirements with respect to a generating facility, absent seller's participation in manipulative conduct.

## **H. Market Behavior Rule 3 (Communications)**

### **1. Commission Proposal**

103. In the June 26 Order, we proposed that sellers be required to "provide complete, accurate, and factual information, and not submit false or misleading information, or omit material information, in any communication with the Commission, market monitors, [RTOs, ISOs], or similar entities." We sought comment on whether this proposed rule would be sufficient in its scope and breadth to cover any and all matters relevant to wholesale markets, including maintenance and outage data, bid data, price and transaction information, and load and resource data. In addition, we sought comment on whether this remedial authority would serve as a useful and appropriate tool in ensuring just and reasonable rates.

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<sup>56</sup> The term "physical withholding" means not offering available supply in order to raise the market clearing price. Such a strategy is only profitable for a firm that benefits from the higher price in the market.

<sup>57</sup> The term "economic withholding" means bidding available supply at a sufficiently high price in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run and where, as a result, the market clearing price is raised. Such a strategy is only profitable for a firm that benefits from the higher price in the market.

<sup>58</sup> To the extent this behavior violated any Commission-approved bidding rules in the applicable power market, moreover, it could also be found to be a violation of Market Behavior Rule 1.

## 2. Comments

104. Commenters argue that the proposed rule should only prohibit violations knowingly committed.<sup>59</sup> Reliant points out that accidental violations, including mistakes made when responding to a request for data, or a reasonable but erroneous understanding of the type or scope of information requested, should not constitute a violation of the rule. EEI adds that unintentional errors and omissions occur in the ordinary course of business. Similarly, EPSA, et al. submit that market participants should retain the right to challenge requests for information and to exercise their judgment in determining the adequacy of a response, subject to subsequent direction from the Commission.

105. Commenters also favor limitation of the proposed rule to “Commission-approved entities” and thus the deletion of the proposed term “or similar entities.”<sup>60</sup> Commenters argue that the application of the rule to entities other than jurisdictional entities would create unnecessary confusion and uncertainty. Undue market uncertainty is also alleged with respect to the potential scope of the proposed rule. Dynegy, for example, argues that the term “material information” creates an overly high and ambiguous standard that is not required to protect sophisticated commercial entities.<sup>61</sup> Similarly, Reliant submits that the word “complete” effectively requires sellers to become mind-readers in order to avoid running afoul of the Commission’s rule.<sup>62</sup> Amerada Hess asserts that it should be left to the RTOs, ISOs, and the market monitors to specify what does and what does not fall within the scope of the rule. Finally, commenters argue that the rule should be modified to require that any entity receiving data pursuant to the rule have appropriate data confidentiality protocols in place in order to ensure the confidentiality of the data it receives.<sup>63</sup>

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<sup>59</sup> See Comments of EPSA, et al. at Attachment B, p.6; Comments of EEI at 18-19; Comments of Duke Energy at 38; Comments of Exelon at 13; Comment of Reliant at 18; Comments of MidAmerican Energy at 5.

<sup>60</sup> See Comments of EPSA, et al. at Attachment B, p. 6; Comments of EEI at 18-19; Comments of Reliant at 18. But see Comments of the California Commission at 6 (proposing that the term “state regulatory authorities” be added to the list of entities to whom accurate information must be provided).

<sup>61</sup> See also Comments of EPSA, et al. at Attachment B, p. 6 (noting that the word “material” is not currently defined).

<sup>62</sup> See also Comments of Central Vermont, et al. at 17.

<sup>63</sup> See Comments of Reliant at 18; Comments of EME at 8; Comments of Pinnacle West at 9.

(continued...)

### 3. Commission Ruling

106. We will adopt Market Behavior Rule 3, as revised. As revised, Market Behavior Rule 3 will require a market-based rate seller to:

*Provide accurate and factual information and not submit false or misleading information, or omit material information in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.*

107. In adopting this rule, we are emphasizing the need for market-based rate sellers to act honestly and in good faith when interacting with the Commission or organizations and entities tasked by the Commission with the responsibility of carrying out non-discriminatory transmission access and wholesale electric market administration. The integrity of the processes established by the Commission for open competitive markets rely on the openness and honesty of market participant communications.

108. We have modified the proposed rule, however, to make clear that it will only apply to communications with the Commission and entities subject to its jurisdiction. We believe that such clarification is appropriate to assure sellers that the information sought or provided hereunder will be directly related to the wholesale transactions for which they have received market-based rate authority.

109. In addition, we clarify that this rule will not be a basis for a jurisdictional entity requesting or receiving information covered by this rule to compel the provision of such information or to fail to provide requested confidential treatment. The ability to compel the provision of information requested and determinations with respect to requests for confidential treatment will depend on the Commission-approved rules and regulations of the institution requesting or receiving the information.

110. We have also revised the rule to assure that inadvertent submission of inaccurate or incomplete information will not be sanctioned. As revised, the rule prohibits the knowing submission of false or misleading data.<sup>64</sup> In this regard, we intend the “due diligence” exception to apply to the entity, not the individual, submitting the data. As such, we expect the seller submitting the information to have in place processes that

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<sup>64</sup> As noted above, we make the same clarification as it relates to Market Behavior Rules 2(b) and 2(c).

assure the accuracy of the submitted information. The submission of false or incomplete information on behalf of a seller by an individual that did not personally know it to be false or incomplete in the absence of a process to insure data accuracy and sufficiency will not excuse the seller's conduct under this rule.

## **I. Market Behavior Rule 4 (Reporting)**

### **1. Commission Proposal**

111. In the June 26 Order, we applied the prohibition against false reporting, as set forth in proposed Market Behavior Rule 3, to the reporting of price data to publishers of electricity or natural gas price indices. We proposed that to the extent sellers engage in reporting of transactions to publishers of electricity or natural gas price indices, sellers will be required to provide complete, accurate and factual information to any such publisher. We further proposed that sellers would be required to notify the Commission of whether they engage in such reporting for all sales and that in addition, sellers would be required to adhere to such other standards and requirements for price reporting as the Commission may order.

112. We noted that Staff, in the Western Markets Report, supported the inclusion of such a requirement in sellers' market-based rate tariffs and authorizations.<sup>65</sup> We sought comment on whether our rule, as proposed, would remedy the abuses outlined by Staff in the Western Markets Report by ensuring that published price indices represent a fair and accurate measure of actual prices and trading volumes. Finally, we noted that in Docket No. AD03-7-000, we were considering certain price formation issues, including a requirement covering the reporting of price data by jurisdictional entities.<sup>66</sup> Accordingly, we proposed to condition our rule by stating that "seller shall adhere to such other standards and requirements for price reporting as the Commission may order."

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<sup>65</sup> See June 26 Order, 103 FERC ¶ 61,349 at P28, citing Western Markets Report at ES-17. We also noted that EPSA, in its code of ethics and sound trading practices, requires its members to "ensure that any information disclosed to the media, including market publications and publishers of surveys and price indices, is accurate and consistent."

<sup>66</sup> Id. at P31.

## 2. Comments

113. Issues raised by commenters with respect to the proposed rule generally mirror the concerns discussed above relating to Market Behavior Rule 3. These concerns include, principally, (i) the absence of an intent standard;<sup>67</sup> (ii) the need for confidentiality when reporting transactions to publishers;<sup>68</sup> and (iii) the importance of clarifying the scope of the information to be reported.<sup>69</sup>

114. With respect to scope, Platts submits that if the Commission does require sellers to state whether they report “all sales” to publishers, the Commission should further specify the information it expects to be provided. Platts argues that sellers should be required in their notification to state whether they are reporting their prices for electricity transactions, gas transactions or both, and to state to which publications they are reporting prices. Platts adds that sellers should be required to state that the information they provide to publishers includes all of the company’s trading at all North American trading points, not merely a complete set of data for those points at which a seller chooses to report data.

115. The Intercontinental Exchange, Inc. (Intercontinental) argues that since there are only a small number of index publishers relative to the hundreds of sellers, the Commission should compel index publishers to reveal the number of sellers reporting transaction-level data and the number of transactions reported for each index at each hub on a daily (for day-ahead indices) and monthly (for month-ahead indices) basis. Finally, NASUCA and TDU Systems argue that Market Behavior Rule 4 should require mandatory reporting in order to restore liquidity and confidence to electricity and natural gas markets. NASUCA submits that this requirement should apply to all purchases as well as sales.

## 3. Commission Ruling

116. We will adopt Market Behavior Rule 4, as revised. As revised, Market Behavior Rule 4 will require that a market-based rate seller comply with the following:

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<sup>67</sup> See Comments of EPSA, et al. at Attachment B, pp. 6-7; Comments of EEI at 20; Comments of MidAmerican Energy at 5; Reliant at 20; Comments of National Energy Marketers Association at 13; Comment of PG&E at 11; Comments of EME at 10.

<sup>68</sup> See, e.g., Comments of EME at 10.

<sup>69</sup> See Comments of Central Vermont, et al. at 18; Comments of the FTC at 17-18; Comments of OPG at 5.

*To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement issued by the Commission in Docket No. PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.*

117. In the June 26 Order, we referred to our on-going proceeding investigating price index formation in Docket No. AD03-7-000. As commenters note, since our proposal regarding these rules was issued, we have issued a Policy Statement addressing standards we believe appropriate for the formation of price indices that will be robust and accurate in the context of a voluntary reporting regime.<sup>70</sup> Included in the Policy Statement is an allowance for a “safe harbor,” pursuant to which reporting errors would not be subject to Commission sanction (e.g., as seller’s conduct may relate to Market Behavior Rule 4).

118. In our rule, as revised herein, we explicitly adopt the standards set forth in the Policy Statement for transaction reporting. Further, we also adopt the “safe harbor” set forth therein as a component of our enforcement policy with respect to this rule. In addition, we make clear that all sellers will be required to inform the Commission of their “reporting status” within 15 days of the effective date of this revision to their tariff and within 15 days of any subsequent change in reporting status.

119. Finally, several commenters suggest that we require mandatory reporting, while other commenters contend that we have created requirements that will have a chilling effect on reporting. We believe that we have struck an appropriate balance in our rule. For the moment, we are attempting to work within the framework of voluntary reporting. We are awaiting Staff’s review of the comprehensiveness of reporting in the wake of our Policy Statement. At this time, we are not mandating reporting. We have engaged in a comprehensive investigation of transaction reporting and related issues and believe the practices set forth in our Policy Statement represent the necessary minimum for those entities that choose to report. Accordingly, we will not require reporting, here, but will set forth practical standards for entities that do report.

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<sup>70</sup> See Price Discovery in Natural Gas and Electric Markets, 104 FERC ¶ 61,121 (2003).

## **J. Market Behavior Rule 5 (Record Retention)**

### **1. Commission Proposal**

120. In the June 26 Order, we noted that in the Western Markets Report, Staff recommended that all electric market-based rate tariffs and authorizations be expressly conditioned to require sellers to retain data and information needed to reconstruct a published price index for a period of three years.<sup>71</sup> Based on Staff's recommendation, we proposed and sought comment on the record retention guidelines set forth in Market Behavior Rule 5. Specifically, we sought comment on whether this Market Behavior Rule, as proposed, would ensure that companies adopt suitable retention policies permitting the Commission and interested entities to better monitor these transactions and practices.

### **2. Comments**

121. Commenters generally agree that a data retention requirement of some kind should be imposed on market-based rate sellers, but disagree over the number of years over which this requirement should apply. Some argue that the data retention period should be reduced from the proposed three-year period to a two-year or even one-year requirement,<sup>72</sup> others request that it be increased to a six-year or even seven-year requirement,<sup>73</sup> and others recommend that it be approved, as proposed.<sup>74</sup>

122. Commenters also raise concerns regarding the scope and specificity of the proposed requirement. EEI, Dynegy and MidAmerican, for example, argue that the language in the rule is too vague, while Exelon submits that the proposed rule would arguably require a seller to retain virtually every piece of paper it generates. These and

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<sup>71</sup>See Western Markets Report at ES-14 and III-52. EPSA, in its code of ethics and sound trading practices, requires its members to "maintain documentation on all transactions for an appropriate period of time as required under applicable laws and regulations."

<sup>72</sup> See Comments of Central Vermont, et al. at 18-19 (two years); Comments of Merrill Lynch, et al. at 9 (two years); Comments of FirstEnergy at 21 (two years) Comments of EPSA, et al. at Attachment B, p. 7 (one year).

<sup>73</sup> See Comments of NASUCA at 23 (six years); Comments of East Texas Cooperatives at 10 (seven years).

<sup>74</sup> See Comments of Reliant at 21.

other commenters conclude that without a more narrow, clearly articulated requirement, the proposed rule could be burdensome and costly.<sup>75</sup> Reliant requests clarification that the data retention requirement not extend to economic analyses associated with the development of prices and bids that underlie the prices charged by a seller (e.g., fuel cost, variable operation and maintenance expenses, or opportunity costs). In addition, Reliant argues that the products specified in Market Behavior Rule 5 be limited to jurisdictional products for which sellers have express authority to sell at market-based rates.

### 3. Commission Ruling

123. We will adopt Market Behavior Rule 5, as revised. As revised, Market Behavior Rule 5 will require a market-based rate seller to:

*Retain, for a period of three years, all data and information upon which it billed the prices it charged for the electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.*

124. In revising this rule, we clarify that we are not seeking retention of “cost-of service” or analytical data related to all sales, as some commenters perceived from our use of the word “reconstruction” in our original proposal. Rather, we are requiring that sellers retain the complete set of contractual and related documentation upon which they billed their customers for their sales. The sales contemplated are sales made pursuant to the seller’s market-based rate tariff. The Commission is indifferent as to whether this material is retained in paper form or in an electronic medium as long as the data can be made accessible in a reasonable fashion if its review is required by the Commission or its Staff.

125. In addition, commenters suggest that the length of the retention period may be burdensome. On balance, however, requiring sellers to retain records for the period proposed, i.e., for three years, will not constitute an undue burden on sellers, particularly given the fact that sellers can satisfy this requirement either by retaining their records in a hard copy form or electronically. To permit a shorter retention period may not allow sufficient time for the investigations into possible violations.

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<sup>75</sup> See, e.g., Comments of Duke Energy at 39-40.

**K. Market Behavior Rule 6 (Related Tariff Matters)****1. Commission Proposal**

126. In the June 26 Order, we noted that in the Western Markets Report, Staff had found that sellers had failed to abide by their market-based rate codes of conduct<sup>76</sup> and their Order No. 889 standards of conduct.<sup>77</sup> We noted that these tariff provisions, among other things, required the functional separation of transmission and wholesale merchant personnel. We sought comment on whether Market Behavior Rule 6, as proposed, was sufficient in its scope and breadth to cover any and all matters relating to violations of the market-based rate codes of conduct and the Order No. 889 standards of conduct.

**2. Comments**

127. Notwithstanding the discussion which accompanied our proposed rule, commenters suggest that the language set forth in Market Behavior Rule 6, as proposed, could be construed to apply to codes of conduct other than sellers' market-based rate codes of conduct. Accordingly, commenters seek clarification that the codes of conduct to which Market Behavior Rule 6 refers are the codes of conduct contained in sellers' market-based rate schedules. EEI also challenges the proposed rule as being too heavy-handed, permitting the Commission, in theory, to revoke a seller's market-based rate authority for any code of conduct or standards of conduct violation, no matter how small or insignificant the infraction (e.g., failing to correctly post a job description).<sup>78</sup>

**3. Commission Ruling**

128. We will adopt Market Behavior Rule 6, as revised. As revised, Market Behavior Rule 6 will require that a market-based rate seller:

*Not violate or collude with another party in actions that violate Seller's*

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<sup>76</sup> The Commission requires a market-based rate code of conduct when a power marketer is affiliated with a public utility with a franchised service area and captive customers. See Carolina Power & Light Company, 97 FERC ¶ 61,063 (2001).

<sup>77</sup> See Open Access Same-time Information System and Standards of Conduct, Order No. 889, FERC Stats. & Regs. ¶ 31,135 (1996), order on reh'g, Order No. 889-A, FERC Stats. & Regs. ¶ 31,049 (1997), reh'g denied, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

<sup>78</sup> See also Comments of EME at 11 (asserting that the proposed rule is vague and ill-defined).

*market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.*

129. Market Behavior Rule 6 is designed to emphasize our commitment to make certain that entities adhere to our electric power sales code of conduct and Order No. 889 standards of conduct. In response to commenter concerns, we have revised this rule to add clarity. In revising this rule, we clarify that this rule applies to a seller's electric power sales code of conduct contained in a Seller's market-based rate tariff or rate schedule as well as seller's Order No. 889 standards of conduct. We intend that any violation of this provision will subject the seller and its affiliates to disgorgement of unjust profits, as applicable, or other remedies as the Commission may find appropriate.

130. We further clarify that, in adopting this rule, it is not the Commission's intention to order disgorgement of unjust profits or other remedies for inadvertent errors (such as incorrectly posting a job description). However, the Commission is concerned with all violations and, in particular, those violations which involve affiliate sales and preferential treatment, including access to transmission information or service.

## **L. Additional Rules and Alternative Options**

### **1. Commission Proposal**

131. In the June 26 Order, we noted that the prohibitions set forth in our proposed Market Behavior Rules represented only one of the tools available to the Commission to ensure just and reasonable rates and that in undertaking our enforcement decisions, we would focus on the best outcome for assuring just and reasonable rates in our jurisdictional markets. We stated that in some instances, significant remedial action may be warranted, while in other instances, we may use a specific set of facts and circumstances to clarify our requirements for acceptable public utility activities. We noted that in formulating our proposed rules, we were required to balance a number of competing interests. We sought comments from interested entities on whether our proposed rules struck the appropriate balance.

### **2. Comments**

132. A number of commenters assert, in effect, that the Commission's proposed Market Behavior Rules fail to strike the necessary balance of interests, given the Commission's asserted failure to address various additional issues.

133. El Paso Electric Company (El Paso), for example, states that June 26 Order failed to examine or otherwise provide any understanding on a number of important threshold questions underlying the Commission's stated objectives in this proceeding. Specifically, El Paso asserts that the Commission is attempting to articulate Market Behavior Rules

without a full understanding of what constitutes a market, what dynamics foster a competitive market, and what kinds of behavior are beneficial or harmful.

134. The FTC points out that structurally competitive markets are generally the best remedy against anticompetitive behavior and that, as such, the Commission should give high priority to achieving structurally competitive markets while it pursues interim measures, if any, to address Market Behavior Rule violations. Similarly, EPSA, et al. submits that the solution for most of the alleged and actual inappropriate market behavior is well-functioning markets with clear and efficient rules that foster efficient investment and competitive behavior.<sup>79</sup>

135. In addition, commenters assert that the Market Behavior Rules should apply to all market participants, including transmission owners and load serving entities (LSEs). AE Supply argues that buyers who manipulate markets to depress prices should be subject to complaints by sellers to recover appropriate surcharges. EEI notes that this could be accomplished by including the Market Behavior Rules in the tariffs administered by all RTOs, ISOs, and the Western Systems Power Pool.

136. APPA, TAPS, and TDU Systems propose that the Commission broaden the scope of its undertaking in this proceeding by addressing structural market issues. APPA and TAPS propose as additional rules, a requirement imposing long-term sales obligations for the benefit of LSEs, a requirement for capacity auctions to de-concentrate generation, and additional rules providing for greater access to transmission and the relief of existing transmission constraints. TDU Systems recommends that the Commission take action on its proposed supply reassessment screen to provide an up-front measure of a seller's potential market power.

### **3. Commission Ruling**

137. We share the views of those commenters who assert that the Commission's proposed Market Behavior Rules, taken alone, will not be adequate to ensure that the rates, terms and conditions offered by market-based rate sellers will be just and reasonable. We also agree with EPSA, et al. and others that a well functioning market

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<sup>79</sup> See also Comments of East Texas Cooperative at 4-6 (stating that the lack of competitive markets remains a fundamental concern); Comments of ANP, et al. at 14 (the Commission should continue to rely on preventive measures tailored to specific markets, rather than adopting blanket rules that, by their own design, cannot stop anticompetitive behavior); Reply Comments of TDU Systems at 3 (noting that the Commission must address not only the behavior of market participants but the structure of the markets themselves).

may be the best single, long-term remedy against the abuse of market power. In fact, the Commission is pursuing these efforts in other concurrent proceedings.<sup>80</sup>

138. As we have recognized in the past, however, even in a structurally competitive market, individual sellers may have the ability to exercise market power. Individual sellers may have the ability to engage in market manipulation or other deceptive practices. Thus, it is appropriate that the Commission delineate well-defined rules of the road applicable to market-based rate sellers. Where these rules are violated, it is appropriate that the Commission provide a remedy for such conduct. It is important that such conduct be deterred to the extent possible.

## **M. Available Remedies and Complaint Procedures**

### **1. Commission Proposal**

139. In the June 26 Order, we indicated that in complaint proceedings brought before the Commission to enforce our proposed Market Behavior Rules, the principal remedy available to complainants for any Market Behavior Rule violation shown to have occurred (in addition to the potential revocation of the seller's market-based rate authority) would be the disgorgement of the seller's unjust profits attributable to the specific violation at issue.<sup>81</sup>

140. In addition, we proposed to limit the applicability of potential disgorgement of unjust profits exposure by requiring that any violation alleged by a market participant be made on a transaction-specific basis and that any market participant request for disgorgement relief be made no later than 60 days after the end of the calendar quarter in which the violation is alleged to have occurred. We proposed that if a market participant can show that it did not know and should not have known of the behavior which forms the basis for its complaint within the period prescribed in our proposal, then the 60-day period would be deemed to run from the time when the market participant knew or should have known of the behavior. Finally, we proposed that these time limitations not apply to enforcement actions undertaken by the Commission.

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<sup>80</sup> See, e.g., Midwest Independent Transmission System Operator, Inc., 105 FERC ¶ 61,145 (2003); California Independent System Operator Corporation, 105 FERC ¶ 61,140 (2003).

<sup>81</sup> June 26 Order, 103 FERC ¶ 61,349 at P38.

## 2. Comments

141. EEI rejects the remedial approach set forth by the Commission in the June 26 Order. EEI asserts that to avoid regulatory uncertainty, the Commission should only pursue remedies on a prospective basis after the Commission identifies new market problems and/or the need for new market rules.

142. Numerous comments (both pro and con) were received regarding the specific financial remedy proposed by the Commission, *i.e.*, a disgorgement remedy. On the one hand, commenters challenge the Commission's authority to impose any remedies at all in this context based on various legal challenges (discussed below), the impracticalities involved in attempting to calculate such a remedy, and/or the commercial undesirability of doing so.<sup>82</sup> Other commenters stake out a position on the opposite end of the spectrum, suggesting that a financial remedy limited to the disgorgement of unjust profits is entirely inadequate, unfair, and will not provide a sufficient deterrent against sellers who violate the Commission's rules.<sup>83</sup> The middle ground position between these two polar views, *i.e.*, a disgorgement remedy that would not require the seller to make the market whole (as proposed by the Commission in the June 26 Order), is supported by EPSA, *et al.* and others.

143. Commenters also stake out a number of different positions regarding the Commission's proposed 60-day complaint limitation rule. EPSA, *et al.* and others submit that this complaint limitation proposal is both necessary and appropriate, as it relates to market participant complaints because, among other things, it will promote transactional certainty.<sup>84</sup> Others, including TDU Systems and East Texas Cooperatives, submit that this time limitation requirement will significantly undermine the Commission's overall objectives in this proceeding. Similarly, Central Maine, *et al.* argue for an extended period in which to file complaints, given (it contends) the complexity of an LMP-based

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<sup>82</sup> See Comments of EEI at 22-26; Comments of TransCanada at 4; Comments of Southern at 18 (noting that it may prove difficult, if not impossible, to calculate unjust profits in the context of market-based rates); Reply Comments of Mirant and TransAlta at 11 (noting that disgorgement liability could completely chill bulk power markets and severely limit capital market access for bulk power market participants); Reply Comments of Cinergy Services, Inc. (Cinergy) at 1-4 (arguing that a make-whole remedy would be unreasonable, unnecessary, impractical, and unauthorized by the FPA).

<sup>83</sup> See Comments of TDU Systems at 10; Nucor Steel, *et al.* at 7; SMUD at 6-7; PG&E at 3; Comments of Cal ISO at 5; Comments of NASUCA at 31; Comments of Cal Oversight Board at 5-6; Reply Comments of Central Maine, *et al.* at 8-9.

<sup>84</sup> See also Reply Comments of EEI at 12-13; Reply Comments of Cinergy at 4-6.

market (and the time it requires to analyze market outcomes), the practicalities associated with billing cycles and correction periods, and the administrative burden associated with determinations of when a particular party knew or should have known of a rule violation. NECPUC submits that, at a minimum, the 60-day rule should be modified by providing all market participants 180 days to file a complaint from the date they know, or should know, of the violation at issue.<sup>85</sup>

144. Commenters also address the Commission's statement in the June 26 Order that it would not be bound by the 60-day complaint limitation requirement applicable to market participant complaints. On the one hand, the Louisiana Commission asserts that this 60-day complaint exemption is appropriate and that it should also apply to state regulators. On the other hand, EPSA, et al. and EEI warn that such an allowance would constitute an open-ended risk that the Commission might question any seller's transaction at any time (even in response to a hotline complaint made by a market participant otherwise precluded from filing a complaint) and would have a chilling effect on the market.<sup>86</sup>

145. Commenters seek a number of clarifications regarding the Commission's role in enforcing its Market Behavior Rules. EPSA, et al. seek clarification that while the Commission might reexamine transactions and provide guidance at any time, it will nonetheless be bound by the time limitation imposed herein with respect to any remedies it might impose. Central Vermont, et al. also seek a limitation on the Commission's authority in this area, proposing that there be a time limit of six months following the date on which the violation is alleged to have occurred for the Commission to initiate an investigation and order disgorgement of unjust profits. The California Commission seeks clarification that a Commission Staff investigation initiated in response to an alleged tariff violation will be open to the public, noting that complaint proceedings initiated by other parties will necessarily be open to the public. Mirant and TransAlta also assert that the triggering event for bringing a complaint or initiating an investigation is unclear in the Commission's proposal. These entities propose that the triggering event be the time that the transaction at issue is entered into, absent fraud or the willful withholding of material information. Finally, Nucor Steel, et al. propose that revocation of a seller's market-based rate authority be made mandatory if it is determined that the seller is in violation of any Market Behavior Rule.

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<sup>85</sup> See also Comments of SMUD at 5-6 (pointing out that a market participant that uncovers a violation on the last day of the calendar quarter has only one third the amount of time to prepare a complaint as a market participant who happens to find evidence of a violation on the first day of the calendar quarter); Reply Comments of TDU Systems at 5.

<sup>86</sup> See also Reply Comments of Mirant and TransAlta at 8.

### 3. Commission Ruling

146. We will adopt the remedies and complaint procedures outlined in the June 26 Order, as revised (see Appendix B). Specifically, we will adopt the remedies and complaint procedures as they relate to market participant complaints, subject to the modification that the complaint limitation period will be 90-days, not 60-days, as proposed. Thus, a complaint must be brought within 90 days from the end of the calendar quarter in which the violation has been alleged to have occurred, unless a complainant can show that it did not know or should not have known of the behavior which forms the basis for its complaint within this time period.

147. Upon consideration of the comments received concerning our 60-day proposal, in the Commission's view the 60-day time period may be insufficient time for parties to discover and act upon violations of these rules. Accordingly, the Commission will modify its original proposal to allow 90 days from the end of the quarter from which a violation occurred for a party to bring a complaint based on these rules. A 90-day time period provides a reasonable balance between encouraging due diligence in protecting one's rights, discouraging stale claims, and encouraging finality in transactions. Furthermore, the Commission clarifies that its exception regarding the time period applicable to the filing of a complaint, where the complainant could not have known of the alleged violation, incorporates a reasonableness standard, i.e., the 90-day time period to file a complaint does not begin to run until a reasonable person exercising due diligence should have known of the alleged wrongful conduct. Rather than being impermissibly vague, this safeguard ensures a sufficient time-period for complainants to discover hidden wrongful conduct and submit a claim.

148. We will also place a time limitation on Commission enforcement action for potential violations of these Market Behavior Rules. The Commission, unlike the market participants who may be buyers or otherwise directly affected by a transaction, may not be aware of actions or transactions that potentially may violate our rules. Thus, the Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. Commission action in this context means a Commission order or the initiation of a preliminary investigation by Commission Staff pursuant to 18 C.F.R. § 1b. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject transaction. Knowledge on the part of the Commission will take the form of a call to our Hotline alleging inappropriate behavior or communication with our enforcement Staff.

149. We will not adopt commenters' additional proposed revisions and arguments. First, we reject EEI's argument that the disgorgement remedy proposed in the June 26 Order is inappropriate, because, EEI asserts, it will retroactively or retrospectively declare actions to be market abuses when such actions were not

envisioned when the rules were promulgated. In fact, EEI's premise is mistaken. Our Market Behavior Rules establish clear advance guidelines to govern market participant conduct. Moreover, in approving these Market Behavior Rules and requiring sellers to be fully accountable for any unjust gains attributable to their violation, we do not foreclose our reliance on existing procedures or other remedial tools, as may be necessary, including generic rule changes or the approval of new market rules applicable to specific markets.<sup>87</sup> As always, we will consider the full range of options available to the Commission to promote competition and to ensure that rates remain just and reasonable.

150. We also reject commenters' assertions that a disgorgement remedy may be difficult to calculate in a particular case, or may operate as a chill on the market in other circumstances. The concerns raised by commenters, in this regard, are speculative at best. Moreover, any such concerns can be fairly evaluated by the Commission on a case-by-case basis, with a full opportunity for input from all interested parties. Thus, we need not reject a disgorgement remedy in all cases simply because it may be inappropriate to apply (and need not be imposed) in a specific case. For the reasons discussed below (see Section H, "Legal Authority") we will also reject the assertion that the Commission is precluded from applying a disgorgement remedy under Section 206 of the FPA or on due process grounds.

151. We also reject commenters' assertions that, in enforcing our Market Behavior Rules, the Commission should consider a make-the-market-whole remedy. In fact, the remedies outlined by the Commission in the June 26 Order, including the possible revocation of Sellers' market-based rate authority, will provide a sufficient inducement for sellers to comply with our rules. Our primary focus, in this regard, is on encouraging appropriate market behavior and deterring inappropriate market behavior.

152. Finally, we will reject the proposal made by Mirant and TransAlta that the triggering event applicable to market participant complaints be the date on which the transaction was entered into, absent fraud or willful withholding of material information on the part of the seller. We will not limit market participant complaints in this way. First, the Commission's Market Behavior Rules address both actions and transactions and thus cannot be limited to dates applicable to transactions alone. For example, the declaration of an outage, as addressed by Market Behavior Rule 1, could be an action that does not necessarily involve a transaction.<sup>88</sup> Second, the June 26 Order was clear that the

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<sup>87</sup> Moreover, if Congress grants the Commission additional remedial power, including the authority to levy civil penalties, the Commission will, in addition to the remedies set forth herein, implement such authority and utilize it when appropriate for violations of these Market Behavior Rules.

<sup>88</sup> In this regard, while we held in the June 26 Order that our disgorgement  
(continued...)

60-day requirement would be triggered by the occurrence of the violation, which (in the case of a transaction) could come well after the transaction date. Finally, the extension of this 60-day period, we said, would be based on whether the complainant knew or should have known of the behavior which forms the basis for its complaint, not fraud or any other conduct that the complainant would be required to attribute to the seller as a pre-condition to its right to seek relief.

## **N. Legal Authority**

### **1. Commission's Findings in the June 26 Order**

153. In the June 26 Order, we concluded that Section 206 of the FPA would not bar the Commission from either approving or enforcing our proposed Market Behavior Rules.<sup>89</sup> We noted that we had initiated this proceeding under Section 206, for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as proposed herein. We stated that should we determine that sellers' currently effective tariffs are unjust and unreasonable or may lead to unjust and unreasonable rates without the inclusion of the market behavior rules we proposed herein, we would require that these tariffs be revised to include the rules prospectively, as Section 206 requires.

154. We also found that the refund limitations of Section 206(b) would not bar the Commission from enforcing our proposed Market Behavior Rules. We found that any remedies stemming from a violation of our proposed tariff provisions would be based on the tariff conditions themselves, as approved herein, and that we were fully authorized to take actions and impose remedies when tariffs are violated.

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remedy, in the context of a market-participant complaint, could only be sought on “transaction-specific basis,” we clarify here that this requirement, as it relates to actions, need only refer to specific actions.

<sup>89</sup> See June 26 Order, 103 FERC ¶ 61,349 at P46. Our discussion of this issue, we noted, was prompted by the comments we received in response to the more broadly-stated tariff condition proposed in our Initial Order issued in this proceeding. See Initial Order, 97 FERC at 61,976 and note 4, supra.

## 2. Comments

155. A number of commenters continue to challenge the Commission's authority to promulgate and/or enforce its proposed Market Behavior Rules, given the asserted limitations of Section 206 of the FPA.<sup>90</sup>

156. In addition, commenters also challenge one or more of the Commission's proposed Market Behavior Rules on due process grounds.<sup>91</sup> Southern, for example, argues that fundamental concepts of due process require that standards of conduct be sufficiently clear and unambiguous so as to provide a reasonable guide by which to identify prohibited conduct.<sup>92</sup> Southern further asserts that basic principles of administrative law require agencies to provide regulated entities with adequate notice of the conduct expected of them.<sup>93</sup> Southern adds that an agency fails to provide fair notice if the regulations and other policy statements issued by the agency are so unclear that regulated entities are unable to identify with ascertainable certainty the standards with which the agency expects parties to conform.<sup>94</sup>

157. AE Supply points to two Commission cases in which the Commission required the proposed tariff provisions at issue to impose a more clear and specific obligation and suggests that applying this same degree of specificity here, the Commission's proposed rules do not pass muster. AE Supply states that in California Power Exchange,<sup>95</sup> the

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<sup>90</sup> See, e.g., Comments of EEI at 27; Comments of ANP. Inc., et al. at 6-10; Comments of Central Vermont, et al. at 3; Comments of Cinergy at 21; Comments of Duke Energy at 14; Comments of FPL Energy, LLC at 9; Comments of Mirant and TransAlta at 6; Comments of TransCanada at 6.

<sup>91</sup> See Comments of EEI at 23; Comments of Southern at 13; Comments of ANP Inc., et al. at 1012; Comments of BPA at 5; Comments of BP Energy Company at 4-5; Comments of Cinergy at 23; Comments of Duke Energy at 8; Comments of InterGen at 9; Comments of Mirant and TransAlta at 18; Comments of TransCanada at 5

<sup>92</sup> See Comments of Southern at 13, citing Gates & Fox, Co. v. OSHRC, 790 F.2d 154, 155 (D.C. Cir. 1986).

<sup>93</sup> Id., citing Satellite Broadcasting Company, Inc. v. FCC, 824 F.2d 1, 3 (D.C. Cir. 1987); McElroy Electronics Corporation v. FCC, 990 F.2d 1351, 1358 (D.C. Cir. 1993).

<sup>94</sup> Id., citing Trinity Broadcasting of Florida, Inc. v. FCC, 211 F.3d 618, 628 (D.C. Cir. 2000).

<sup>95</sup> 88 FERC ¶ 61,112 at 61,265 (1999).

(continued...)

Commission held that a tariff provision addressing the improper use of market power could only prohibit specific actions or specific outcomes and required the utility to provide actual examples of the specific actions that would be prohibited. AE Supply further notes that in New York Independent System Operator, Inc.,<sup>96</sup> the Commission rejected a proposed market power mitigation remedy, in part, because the New York ISO had not described with enough specificity the types of conduct that would trigger the imposition of the proposed measures and because the New York ISO had not established specific thresholds or bright line tests that would trigger the conclusion that market power had been exercised.

### **3. Commission Ruling**

158. For the reasons discussed below, we find that: (i) the Commission is not barred by Section 206 of the FPA from approving Market Behavior Rules applicable to market-based rate sellers, or allowing as a remedy the disgorgement of unjust profits and other remedies, as discussed herein; and (ii) these Market Behavior Rules are not unduly vague or overbroad.

159. First, we reject the suggestion that the potential financial consequences for sellers found to be in violation of the Commission's Market Behavior Rules would violate the refund limitations set forth in Section 206(b) of the FPA.<sup>97</sup> As we noted in the June 26 Order, we initiated this proceeding under Section 206 for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as proposed herein. We stated that should we determine that sellers' currently effective tariffs are unjust and unreasonable or may lead to unjust and unreasonable rates without the inclusion of Market Behavior Rules, we would require that these tariffs be revised, but only on a prospective basis, as Section 206 requires.

160. Our Market Behavior Rules will operate as conditions to the grant of market-based rate authority and the Commission, in such a case, has broad authority to impose

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<sup>96</sup> 89 FERC ¶ 61,196 at 61,605 (1999).

<sup>97</sup> Section 206(b) requires that any refunds made in a Section 206 proceeding initiated by the Commission on its own motion be based on a refund effective date no earlier than 60 days after the publication by the Commission of notice of its intent to initiate such a proceeding, or, in the case of a complaint, no earlier than 60 days after the complaint was filed. Section 206(b) also limits the refund effective period to five months after the expiration of such 60-day period.

conditions that will help ensure that rates are within a zone of reasonableness. We held in the June 26 Order and reiterate here that the approval of Market Behavior Rules, under these circumstances, and any future remedies imposed for their violation, would neither violate the filed rate doctrine nor the refund limitations of Section 206(b).<sup>98</sup>

161. Further, the Commission has the authority to impose the appropriate remedy where it finds that violations of its Market Behavior Rules have occurred.<sup>99</sup> In particular, we reject the argument that a violation of an existing condition of service may not be remedied by the Commission from the time the violation occurred. In fact, the courts have held that the Commission has this authority in the fully analogous context presented by the Natural Gas Act (NGA).<sup>100</sup> The courts have also held that the Commission has a great deal of discretion when imposing remedies devised to arrive at maximum reinforcement of Congressional objectives.<sup>101</sup> In devising its remedy, the Commission is required to exercise its discretion to arrive at an appropriate remedy,<sup>102</sup> and to explore all equitable considerations and practical consequences of its action pursuant to its statutory delegation.<sup>103</sup>

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<sup>98</sup> See *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, et al., 97 FERC ¶ 61,121, 61,370 (2000), order on reh'g, *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, et al., 97 FERC ¶ 61,275 (2001), appeal pending, *Public Utilities Commission of the State of California, et al. v. FERC*, Nos. 01-71051, et al. (9<sup>th</sup> Cir., June 29, 2001).

<sup>99</sup> See, e.g., *Coastal Oil Corp. v. FERC*, 782 F.2d 1249 (D.C. Cir. 1986).

<sup>100</sup> See *Consolidated Gas Transmission Corp., et al.*, 771 F.2d 1536 (D.C. Cir. 1985) (holding that the Commission has the authority under Section 16 of the NGA to order retroactive refunds to enforce conditions in certificates).

<sup>101</sup> The courts have held that “the breadth of agency discretion is, if anything, at its zenith when the action assailed relates . . . to the fashioning of policies, remedies and sanctions.” *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 109 (D.C. Cir. 1984), quoting *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

<sup>102</sup> *Gulf Oil Corp. v. FPC*, 536 F.2d 588 (3<sup>rd</sup> Cir. 1977), cert denied, 434 U.S. 1062 (1978), reh'g denied, 435 U.S. 981 (1978).

<sup>103</sup> *Continental Oil Co. v. FPC*, 378 F.2d 510 (5<sup>th</sup> Cir. 1967) and *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962).

162. In addition, this order is based upon the Commission's finding after hearing that existing tariffs are unjust and unreasonable under Section 206 of the FPA. In a proceeding brought pursuant to these rules, the issue would be whether the entity has violated its tariff. Therefore, in a remedial proceeding brought pursuant to these rules, unlike an FPA Section 206 investigation initiated by the Commission, the regulated entity has notice of the conditions required for service at the time of the implementation of the service conditions and the Commission may, at its discretion, fashion an appropriate remedy.

163. In addition, we find that our Market Behavior Rules, including specifically the prohibitions set forth in Market Behavior Rule 2 (relating to market manipulation), are not unduly vague on their face.<sup>104</sup> While constitutional due process requirements mandate that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit,<sup>105</sup> this standard is satisfied "[i]f, by reviewing [our rules] and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform."<sup>106</sup> Our Market Behavior Rules will satisfy this due process requirement "so long as they are sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve, would have fair warning of what the regulations require."<sup>107</sup>

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<sup>104</sup> We note that due process challenges regarding the application of our rules to a particular case are not presented in this proceeding. Thus, commenters' arguments are limited to a facial challenge to our rules, *i.e.*, an assertion that one or more of our rules is vague in all its possible applications.

<sup>105</sup> See Freeman United Coal Mining Company v. Federal Mine Safety and Health Review Commission, 108 F.3d 358, 362 ((D.C. Cir. 1997) (Freeman)).

<sup>106</sup> See General Electric Co. v. EPA, 53 F.3d 1324, 1329-30 (D.C. Cir. 1995) (holding that the agency's interpretation of its rules was "so far from a reasonable person's understanding of the regulations that [the regulations] could not have fairly informed GE of the agency's perspective.").

<sup>107</sup> See Freeman, 108 F.3d at 362. See also Faultless Division, Bliss & Laughlin Industries, Inc. v. Secretary of Labor, 674 F.2d 1177, 1185 (7<sup>th</sup> Cir. 1982) ("[T]he regulations will pass constitutional muster even though they are not drafted with the utmost precision; all that due process requires is a fair and reasonable warning.").

164. As applied by the courts, this due process standard has been held to allow for flexibility in the wording of an agency's rules and for a reasonable breadth in their construction.<sup>108</sup> The courts have recognized, in this regard, that specific regulations cannot begin to cover all of the infinite variety of cases to which they may apply and that “[b]y requiring regulations to be too specific, [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation.”<sup>109</sup>

165. The Supreme Court has further noted that the degree of vagueness tolerated by the Constitution, as well as the relative importance of fair notice and fair enforcement, depend in part on the nature of the rules at issue.<sup>110</sup> In Hoffman, for example, the Court held that in the case of economic regulation (as opposed to criminal sanctions), the vagueness test must be applied in a less strict manner because, among other things, “the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process.”<sup>111</sup>

166. Applying these standards here, we find that our Market Behavior Rules satisfy the requirement of due process. Market Behavior Rule 1, for example, gives sellers “ascertainable certainty” that in operating and scheduling their generation facilities, undertaking maintenance, declaring outages, and committing or otherwise bidding supply, they must do so in a manner that “complies with the Commission-approved rules and regulations of the applicable power market.” There can be no reasonable uncertainty, in this regard, as to what these broadly-practiced, generally-understood activities encompass in the wholesale electric utility industry (*i.e.*, operating facilities, scheduling,

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<sup>108</sup> See Grayned v. City of Rockford, 408 U.S. 104, 110 (1971) (holding that an anti-noise ordinance was not vague where the words of the ordinance “are marked by flexibility and reasonable breadth, rather than meticulous specificity.”).

<sup>109</sup> See Ray Evers Welding Co. v. OSHRC, 625 F.2d 726, 730 (6<sup>th</sup> Cir. 1980).

<sup>110</sup> See Village of Hoffman Estates, et al. v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1981) (Hoffman).

<sup>111</sup> Id. See also Texas Eastern Products Pipeline Co. v. OSHRC, 827 F.2d 46, 50 (7<sup>th</sup> Cir. 1987) (“Texas Eastern, as a major pipeline company, in which trenching and excavation are a part of its routine, had ample opportunity to know of the earlier interpretation, should have been able to see the sense of the regulations on their face, and if still in doubt Texas Eastern should have taken the safer position both for its employees and for itself.”).

undertaking maintenance, declaring outages, and bidding supplies). Nor can there be any reasonable doubt as to the “rules and regulations” to which the rule applies.<sup>112</sup>

167. Similarly, we cannot agree that the prohibitions against market manipulation, as set forth in Market Behavior Rule 2, are unclear in their requirement. It should be noted, in this regard, that our requirement that seller’s actions or transactions have a “legitimate business purpose” is intended to give sellers an opportunity to explain their actions, while still safeguarding market participants against market manipulation for which there can be no legitimate business purpose attached. Sellers will not be required to guess at the meaning of this term, as applied, then, because the term can only have meaning with specific reference to a seller’s own business practices and motives, *i.e.*, if the seller has a legitimate business purpose for its actions or transactions, it cannot be sanctioned under this rule.

168. Moreover, as fully discussed in the June 26 Order and reiterated above, there is an important justification underlying our prohibition against market manipulation. We must be able to protect market participants against abuses whose precise form and nature cannot be envisioned today. As we have previously stated, in establishing these rules, we have worked to strike a necessary balance. We have attempted to set forth with sufficient specificity the class of behaviors we intend to prohibit and to do so in a manner that will inform market-based rate sellers of the type of activities that are consistent with just and reasonable rates. At the same time, we have also attempted to maintain our ability to address particular activities and situations that cannot be envisioned today. Our Market Behavior Rules, we have said, are designed to codify our requirements and provide a regulatory vehicle for their enforcement going forward.

169. The Commission would not be able to fulfill its statutory responsibilities, however, if it established rules addressing future activities based only on the specificity of the past. While we have provided clarity and specificity, where possible, with respect to our experience with past market conduct, we must also establish general rules to prohibit a class of behavior going forward if we are to adequately protect customers to ensure that rates are the product of competitive forces (and thus are just and reasonable). Thus, our Market Behavior Rules have been designed to meet these twin objectives -- to be specific in order to inform sellers as to the type of behavior that is prohibited today, while containing enough breadth and flexibility to address new and unanticipated activities, as they may arise in the future.

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<sup>112</sup> In fact, as discussed above, we are adopting the clarification that the rules and regulations to which this rule refers are limited to “Commission-approved” rules and regulations.

170. In sum, we believe our Market Behavior Rules, as modified, explained and approved herein, put sellers and all market participants on fair notice regarding the conduct we seek to encourage and the conduct we seek to prohibit. Stripped to their essentials, these guidelines amount to the following: (i) act consistently within the Commission's established rules; (ii) do not manipulate or attempt to manipulate power markets; (iii) be honest and forthright with the Commission and the institutions it has established to implement open-access transmission and entities publishing indices for the purpose of price transparency; and (iv) retain associated records. Viewed in this context, there can be no reasonable uncertainty over the underlying objectives embodied in our rules or their requirements going forward.

171. Nonetheless, we are committed to making our Market Behavior Rules as specific as they possibly can be and thus, as discussed above, we are adopting a number of the revisions proposed by commenters in order to better focus and fine-tune the scope and application of our rules.

172. With respect to Market Behavior Rule 2, we have clarified that the rule applies to actions without a legitimate business purpose which are undertaken for the purpose of manipulation of wholesale power markets or prices and that actions which are explicitly contemplated in Commission approved processes such as virtual load or supply bidding are not considered manipulation.<sup>113</sup> We have further explained that implementing Market Behavior Rule 2, we will consider all of the relevant facts and circumstances surrounding the particular transaction in question to determine whether the market-based rates sellers actions were without a legitimate business purpose but rather taken to impact the competitive market in a manner inconsistent with just and reasonable rates. We recognize that our standard is necessarily non-specific with respect to the particular activities it prohibits but believe that our explanation of its meaning and associated enforcement philosophy accompanying the rule make clear that we are acting to prohibit actions which create or are designed to create artificial prices which would not have existed in a competitive market but for the manipulative acts. We have provided specific examples of such acts in Market Behavior Rule 2(a) through 2(d).<sup>114</sup> As explained above, we expect

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<sup>113</sup>Statutes such as Section 10(b) of the Securities and Exchanges Act of 1937, 15 U.S.C. § 78j (2000), prohibit the usage of any "manipulative or deceptive device or contrivance" in connection with the sale of securities. Courts have recognized that specific examples of such prohibited activities would emerge over time while market participants understood that "market manipulation" related to certain types of practices.

<sup>114</sup> As noted above, we have also deleted proposed Market Behavior Rule 2(e).

our administration of this rule will provide a vehicle to highlight specific prohibited activities on a case-by-case basis.

173. We have also revised the language of Market Behavior Rules 3 and 4 to assure that inadvertent factual errors in communications will not be sanctionable under our rules and, with respect to Market Behavior Rule 3, that only the Commission and entities relied upon by the Commission to implement open access transmission are the entities triggering seller's factual reporting obligations. We have also revised Market Behavior Rule 5 to make clear that we are not requiring "cost-based" or other data but rather the data upon which the seller based its market-based charges to its buyer and upon which it reported its transactions to index publishers.

174. In sum, we have carefully considered our proposal and the comments we have received in light of our obligation to assure that wholesale power rates are just and reasonable and that sellers subject to our regulation are fairly apprised of their obligations as participants in a competitive power market subject to Commission oversight. We believe the rules we are establishing herein will allow us to assure just and reasonable rates and provide an adequate basis for sellers to understand our expectations of them.

## **O. RTO/ISO Coordination Issues**

### **1. Commission Proposal**

175. In the June 26 Order, we noted that the Market Behavior Rules we were proposing would apply to any market-based rate sale, whether in the bilateral market or in an organized market, *i.e.*, in the bid-based markets administered by RTOs or by an ISO. We stated that these Market Behavior Rules were intended to complement any RTO or ISO tariff conditions and market rules that may apply to sellers in these markets.<sup>115</sup>

### **2. Comments**

176. Commenters disagree over whether and to what extent the Commission's Market Behavior Rules should be applied in organized markets. Some argue that in these markets, the Market Behavior Rules should not apply.<sup>116</sup> The New York ISO, the New York Commission, and ELCON seek clarification, in this regard, that when a generator unit operates and bids within the automated mitigation procedure (AMP) thresholds

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<sup>115</sup> See June 26 Order, 103 FERC ¶ 61,349 at P8.

<sup>116</sup> See Comments of AES at 5; Comments of Exelon at 5.

established by the New York ISO, such behavior will not be treated as a violation of any Market Behavior Rule.

177. Others assert that the Commission's Market Behavior Rules should play a vital role in the organized markets. Central Maine, *et al.*, for example, point out that market power problems have continued to plague the LMP markets, notwithstanding the oversight and intervention of market monitors.

178. EEI asserts that market participants should not be left with conflicting sets of rules and no guidance as to which applies or which takes precedence over the other. EEI recommends that where there is an inconsistency between the Market Behavior Rules and an RTO or ISO tariff provision approved by the Commission, the Market Behavior Rule should be treated as subordinate. This is appropriate, EEI argues, because the RTO or ISO tariff provision, in this instance, will be the product of a regional stakeholder process specifically suited to meeting regional energy market needs.

179. EPSA, *et al.*, on the other hand, argue that while regional differences may be appropriate on various discrete matters, many of the Market Behavior Rules address generic issues and should be applied uniformly across all markets.

### **3. Commission Finding**

180. In our discussion of Market Behavior Rule 1, above, we clarified that absent inclusion in a broader manipulative scheme addressed in Market Behavior Rule 2, compliance with the Commission-approved rules and regulations of an applicable power market, such as an ISO/RTO market, will serve as compliance with our behavioral rules.<sup>117</sup> However, in order to provide as much clarity as possible to market participants and market monitoring units (MMUs), we will also provide guidance concerning how we expect both these Market Behavior Rules and ISO/RTO rules to be applied and enforced by the Commission and MMUs.

181. As stated in our order issued in Docket No. RT03-1-000 (Communications with Commission-Approved Market Monitors), MMUs may be viewed as the "functional equivalent" of the Commission's staff and, for example, are not typically subject to our *ex parte* rules in communicating with the Commission or Commission Staff.<sup>118</sup> In this

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<sup>117</sup> See *supra*, Section A.

<sup>118</sup> See *Communications with Commission-Approved Market Monitors*, 102 FERC ¶ 61,041 (MMU Communications Order), *order denying reh'g*, 103 FERC ¶ 61,151 (2003).

regard, in ISO/RTO tariffs, we have approved certain limited authority to MMUs to enforce tariffs and implement sanctions for a market participant's failure to comply with tariff requirements.<sup>119</sup> In each case, the determination of a tariff violation and the sanctions imposed may be appealed to the Commission.

182. We believe it is appropriate to authorize MMUs to enforce certain ISO/RTO tariff matters if those matters are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff.<sup>120</sup> Beyond this defined MMU authority, sellers' behavior will be subject to direct Commission enforcement in the first instance, regardless of whether the behavior occurs in ISO/RTO administered markets or bilateral markets. Market-based rate authority has been granted to sellers not only based on a finding of lack, or mitigation, of market power, but also with the expectation that such seller will not act in an anti-competitive manner. Through our administration of these rules, the Commission can assure that anti-competitive behavior is not countenanced and that rates remain just and reasonable.

183. While MMUs may take actions as authorized by the ISO/RTO tariff, the Commission retains its responsibility to oversee tariff compliance on the part of any market-based rate seller. For example, a repeated pattern of tariff violations across several markets could lead the Commission to consider revoking a seller's market-based rate authorization. Further, except to the extent that enforcement authority has explicitly been authorized for an MMU in an ISO/RTO tariff, these behavioral rules will apply and be administered by the Commission.

184. The roles of the MMUs and the Commission will require the Commission staff and the MMUs to continue to forge a close working relationship. This process has been underway for some time. Commission Staff is coordinating data collection and reporting functions with MMUs, including developing appropriate triggers for referring compliance issues to the Commission. We expect an MMU to maintain an on-going dialogue with our staff so that we are apprised at all times of the status of the markets and activities of market participants. If an MMU becomes aware of activities of a market participant that

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<sup>119</sup> See, e.g., New York Independent System Operator, Inc., 96 FERC ¶ 61,249 (2001).

<sup>120</sup> With respect to such matters, we will rely on the MMUs to identify and take action with respect to a specific behavior covered in the tariff, subject to later appeal to the Commission. If the MMU does not take action in such a case, the seller, absent an appeal to the Commission, will not be exposed to subsequent Commission enforcement actions regarding behavior found acceptable by the MMU.

appear to violate that market participant's market-based rate tariff condition or other requirement that has not been assigned to the MMU for enforcement in the first instance, the MMU is expected to bring the matter to the attention of the Commission staff.<sup>121</sup>

185. Therefore, the behavioral rules adopted by the Commission for market-based rates sellers will apply to all markets. To the degree these rules overlap with a clearly stated tariff provision for which the Commission has assigned the first-line enforcement authority with associated sanctions to a MMU subject to appeal to the Commission, we will defer in the first instance to the MMU, subject to possible review. The Commission will exclusively undertake consideration of all other asserted violations of these rules. The Commission staff and the MMUs will work together to act to comprehensively assure that the overall competitiveness of jurisdictional electricity markets is maintained.

186. In addition, as discussed in our consideration of Market Behavior Rule 1, absent a situation in which an activity is part of a broader manipulative scheme prohibited by Market Behavior Rule 2, a compliance with Commission-approved ISO and RTO rules (such as bidding consistent with the AMP process in the New York ISO) will be deemed in compliance with these market behavior rules.

## **P. Administrative Findings and Notices**

### **1. Information Collection Statement**

187. As noted above, the Market Behavior Rules approved herein will require jurisdictional market-based rate sellers, to the extent they engage in reporting of transactions to publishers of electricity or natural gas price indices, to provide accurate and factual information and not submit false or misleading information or omit material information to any such publisher.<sup>122</sup> In addition, these Market Behavior Rules will

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<sup>121</sup> We have stated that the MMUs “serve an important practical and unique function as the Commission’s ‘eyes and ears’ in the marketplace, and are charged with reporting back to the Commission any problems and anomalies which they encounter so that the Commission may take appropriate action under the Federal Power Act.” See MMU Communications Order, 102 FERC at 61,091. In other words, the most important function an MMU performs is to provide feedback to the Commission in order for the Commission to take substantive action in accord with the statute. As we have stated, MMUs “are practically an extension, or a surrogate for, the Commission’s own monitoring and investigative staff.” Id.

<sup>122</sup> See Appendix A at Market Behavior Rule 4.

require market-based rate sellers to retain certain records for a minimal period of three years, as required by Market Behavior Rule 5.<sup>123</sup>

188. Given these requirements, the collection of information set forth below has been submitted to the Office of Management and Budget (OMB) for review under Section 3507(d) of the Paperwork Reduction Act of 1995.<sup>124</sup> OMB's regulations require OMB to approve certain information collection requirements imposed by agency rule.<sup>125</sup> The Commission identifies the information provided for under this order as FERC-516, Electric Rate Schedule Filings.

Data Collection	Number of Respondents	Number of Responses	Hours Per Response	Total Annual Hours
FERC-516				
(Reporting)	864	3	1.5	3,888
(Recordkeeping)	864	1	5.0	4,320
Totals			6.5	8,208

Total annual hours for Collection (reporting + recordkeeping) = 8,208

189. Information Collection Costs: The Commission seeks comments on the cost to comply with these requirements. It has projected the average annualized cost of all respondents to be: \$252,720 (3,888 @ \$65.00 per hour, for reporting) + \$2,000,160 (4,320 hours @ \$31.00 per hour + \$1,866,240 maintenance/storage/recordkeeping) = \$2,252,880.

190. OMB's regulations require it to approve certain information collection requirements imposed by agency rule. The Commission is submitting a copy of this order to OMB.

Title: Electric Rate Schedule Filings

Action: Proposed Collection

OMB Control No. 1902-0096

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<sup>123</sup> Id. at Market Behavior Rule 5.

<sup>124</sup> 44 U.S.C. §3507(d) (2000).

<sup>125</sup> 5 C.F.R. § 1320.12 (2003).

Respondents: Businesses or other for profit.

Frequency of Responses: On occasion.

Necessity of Information: The Market Behavior Rules approved herein will revise market-based rate sellers' tariffs and authorizations and are intended to ensure that rates and terms of service offered by market-based rate sellers remain just and reasonable.

Internal review: The Commission has reviewed the requirements pertaining to Market Behavior Rules 4 and 5 and has determined that these tariff conditions are necessary to ensure just and reasonable rates. These tariff requirements, moreover, conform to the Commission's plan for efficient information collection, communication, and management within the electric utility industry. The Commission has assured itself, by means of internal review, that there is specific, objective support for the burden estimates associated with the information/data retention requirements.

191. Interested persons may obtain information on the information requirements by contacting the following: Federal Energy Regulatory Commission, 888 First Street, NE, Washington, D.C. 20426 [Attention: Michael Miller, Office of the Executive Director, Phone (202)502-8415, fax: (202)273-0873, e-mail: [michael.miller@ferc.gov](mailto:michael.miller@ferc.gov).]

192. For submitting comments concerning the collection of information and the associated burden estimates, please send your comments to the contact listed above and to the Office of Management and Budget, Office of Information and Regulatory Affairs, Washington, D.C. 20503, [Attention: Desk Officer for the Federal Energy Regulatory Commission, phone: (202)395-7856, fax: (202)395-7285.]

## 2. Environmental Analysis

193. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.<sup>126</sup> The Commission has categorically excluded certain actions from these requirements as not having a significant effect on the human environment.<sup>127</sup>

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<sup>126</sup> Order No. 486, Regulations Implementing the National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs. Preambles 1986-1990 ¶ 30,783 (1987).

<sup>127</sup> 18 C.F.R. § 380.4 (2003).

The actions proposed to be taken here fall within categorical exclusions in the Commission's regulations for rules that are clarifying, corrective, or procedural, for information gathering, analysis, and dissemination, and for sales, exchange, and transportation of natural gas that requires no construction of facilities.<sup>128</sup> Therefore, an environmental assessment is unnecessary and has not been prepared in connection with this order.

### **3. Regulatory Flexibility Act Certification**

194. The Regulatory Flexibility Act of 1980 (RFA)<sup>129</sup> generally requires a description and analysis of final rules that will have significant economic impact on a substantial number of small entities. The Commission is not required to make such analyses if a rule would not have such an effect.<sup>130</sup>

195. The Commission does not believe that the Market Behavior Rules approved herein would have such an impact on small entities. Most of the sellers required to comply with the proposed regulations would be entities who do not meet the RFA's definition of a small entity whether or not they are under the Commission's jurisdiction. Therefore, the Commission certifies that this rule will not have a significant economic impact on a substantial number of small entities.

### **4. Document Availability**

196. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426

197. From FERC's Home Page on the Internet, this information is available in the eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

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<sup>128</sup> Id. at §§ 380.4(a)(2)(ii), 380.4(a)(5), and 380.4(a)(27).

<sup>129</sup> 5 U.S.C. § 601-612 (2000).

<sup>130</sup> Id. at § 605(b).

198. User assistance is available for eLibrary and the FERC's website during normal business hours by contacting FERC Online Support at [FERCOnlineSupport@ferc.gov](mailto:FERCOnlineSupport@ferc.gov) or toll free at (866)292-3676 or for TTY, contact (202)502-8659.

## **5. Effective Date and Congressional Notification**

199. The Commission has determined that the Market Behavior Rules approved in this order do not constitute a "major rule" as defined in Section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996. The provisions of 5 U.S.C. § 801 regarding Congressional review of Final Rules, therefore, do not apply to this order.

### **Q. Mirant Corp. v. FERC**

200. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a "Temporary Restraining Order Against the Federal Energy Regulatory Commission" (TRO) in In re Mirant Corp. (Mirant v. FERC), Adversary Proceeding No. 03-4355, which enjoins the Commission "from taking any action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the Court unless FERC shall have provided the Debtors with ten (10) days' written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph."

201. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission's disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this order requires Mirant to act in a manner proscribed by the TRO, the order will provide written notice to Mirant of the action that the Commission will take with respect to a covered Mirant Wholesale Contract.

### **The Commission orders:**

(A) The Market Behavior Rules set forth in Appendix A to this order are hereby adopted, as discussed in the body of this order, to become effective 30 days from the date of issuance of this order.

(B) In compliance with this order, market-based rate sellers are hereby directed to include the Market Behavior Rules, as approved herein, at such time as they file any

amendment to their market-based rates tariff or (if earlier) at such time as they seek continued authorization to sell at market-based rates (e.g., in their three-year update filings). Notwithstanding this time allowance, as applicable to sellers' compliance filings, the effective date for the tariff revisions approved herein shall be the effective date, as specified in ordering paragraph A, above.

(C) The Secretary shall promptly publish this order in the Federal Register.

(D) Southern's request for rehearing of the June 26 Order is hereby dismissed, as discussed in the body of this order.

(E) The entities listed in Appendix C to this order shall be treated as parties to this proceeding.

By the Commission. Commissioners Massey and Brownell concurring with separate statements attached.

( S E A L )

Linda Mitry,  
Acting Secretary.

## Appendix A

**Market Behavior Rules**

As a condition of market-based rate authority, [Company Name] (hereafter, Seller) will comply with the following Market Behavior Rules:

1. **Unit Operation:** Seller will operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.
  
2. **Market Manipulation:** Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule. Prohibited actions and transactions include, but are not limited to:
  - a. pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades");
  - b. transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service or products sold as firm), unless Seller exercised due diligence to prevent such occurrences;
  - c. transactions in which an entity first creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such an occurrence; and
  - d. collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.

3. **Communications**: Seller will provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.
4. **Reporting**: To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement issued by the Commission in Docket No.PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.
5. **Record Retention**: Seller shall retain, for a period of three years, all data and information upon which it billed the prices it charged for the electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.
6. **Related Tariffs**: Seller shall not violate or collude with another party in actions that violate Seller's market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.

Any violation of these Market Behavior Rules will constitute a tariff violation. Seller will be subject to disgorgement of unjust profits associated with the tariff violation, from the date on which the tariff violation occurred. Seller may also be subject to suspension or revocation of its authority to sell at market-based rates or other appropriate non-monetary remedies.

### **Remedies and Complaint Procedures**

Complaints alleging any violation of the Commission's Market Behavior Rules will be subject to the following remedies and procedures, in addition to all other remedies and procedures, as may be applicable, pursuant to the Commission's Rules of Practice and Procedure.

- (1) Any complaint seeking relief for a violation of the Commission's Market Behavior Rules shall be made no later than 90 days after the end of the calendar quarter in which the violation is alleged to have occurred.
- (2) If a complainant can show that it did not know and should not have known of the behavior which forms the basis for its complaint, within the period prescribed by these procedures, then the 90-day period will be deemed to run from the time when the complainant knew or should have known of the behavior.
- (3) Commission action on a complaint not meeting the filing deadlines, as prescribed in these procedures, will be prospective only.
- (4) The applicability of the Commission's disgorgement remedy in any complaint proceeding alleging a violation of the Commission's Market Behavior Rules will be limited by requiring that any such violation be shown to have occurred on a transaction-specific basis.
- (5) The Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. Commission action, in this context, means a Commission order or the initiation of a preliminary investigation by Commission Staff pursuant to 18 C.F.R. Section 1b. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject action or transaction. Knowledge on the part of the Commission must take the form of a call to our Hotline alleging inappropriate behavior, communication with our enforcement Staff.

**Entities Filing Comments and/or Reply Comments**

AES Eastern Energy, L.P.  
Allegheny Energy Supply Company, LLC  
Amerada Hess Corporation  
American National Power, Inc., PPL Energy Plus, LLC and Sempra Energy \*  
American Public Power Association and Transmission Access Study Group \*  
Bonneville Power Administration  
BP Energy Company  
California Electricity Oversight Board  
California Independent System Operator Corporation  
Public Utilities Commission of the State of California  
Canadian Electricity Association  
Central Maine Power Company, New York State Electric & Gas Corporation and  
Rochester Gas and Electric Corporation \*\*  
Central Vermont Public Service Corporation, El Paso Electric Company, Southern  
Indiana Gas & Electric Company & WPS Resources Corporation  
City of Seattle, Washington  
Colorado Office of Consumer Counsel, et al  
Connecticut Department of Public Utility Control  
Cinergy Services, Inc.  
Duke Energy Corporation  
Dynegy Power Marketing, Inc., et al.  
East Texas Cooperatives  
Eastern Energy, L.P.  
Edison Electric Institute  
Edison Mission Energy  
ELCON, et al.  
Electric Power Supply Association, Independent Energy Producers of California,  
Independent Power Producers of New York, Inc. and the Western Power Trading  
Forum \*  
El Paso Electric Company  
Entergy Services, Inc.  
Exelon Corporation  
Federal Trade Commission  
FPL Energy, LLC  
FirstEnergy Service Company  
Intercontinental Exchange, Inc.  
Intergen North America, L.P.  
Louisiana Public Service Commission

Merrill Lynch Capital Services, Inc. (Morgan Stanley Capital Group, Inc.)  
MidAmerican Energy Company  
Mirant Americas Energy Marketing, L.P. and TransAlta Energy  
Marketing (U.S.), Inc. \*  
Modesto Irrigation District  
Montana Consumer Counsel  
Montana Public Service Commission  
National Association of State Utility Consumer Advocates  
National Energy Marketers Association  
National Rural Electric Cooperative Association  
New England Conference of Public Utility Commissioners  
New York Independent System Operator  
New York State Public Service Commission  
NiSource Inc.  
Northeast Utilities Service Company  
Ontario Power Generation Inc.  
PacificCorp  
Pacific Gas and Electric Company  
Pinnacle West Companies  
PJM Industrial Customer Coalition  
PLATTS  
Powerex Corp.  
PPL Montana, LLC and PPL EnergyPlus, LLC \*\*  
Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc.  
Sacramento Utility District  
Southern California Edison Company  
Southern Company Services, Inc.  
Steel Producers  
TECO Energy, Inc.  
TransCanada Companies  
Transmission Dependent Utility Systems  
Tucson Electric Power Company  
Williams Energy Marketing & Trading Company

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\* Entities Filing Both Comments and Reply Comments  
\*\* Entities Filing Reply Comments Only

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public  
Utility Market-Based Rate Authorizations

Docket Nos. EL01-118-000  
and EL01-118-001

(Issued November 17, 2003)

MASSEY, Commissioner, concurring in part:

The tariff conditions that the Commission approves today send a clear message to market-based rate sellers: don't lie, don't manipulate market conditions, don't violate market rules and don't collude with others. For sellers who choose to behave otherwise, the Commission now has the tools to sanction such bad behavior and we give notice of what some of those sanctions could be. This action should help to restore the faith in energy markets that has been lost in the last few years.

There is one aspect of today's order, however, that I would have written differently. I would not limit the monetary penalty for tariff violations to disgorgement of unjust profits. Market manipulation can raise the market prices paid by all market participants and collected by all sellers. In such a case, the appropriate remedy may be that the manipulating seller makes the market whole. I would prefer to not take this or any monetary remedy off of the table, but instead to allow the Commission the flexibility to tailor the remedy to the circumstances of each case.

This one concern with today's order should not be interpreted, however, as diminishing in any way my enthusiastic support for this otherwise excellent order. I commend my colleagues for taking this important and much needed step.

For these reasons, I concur in part with today's order.

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William L. Massey  
Commissioner

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Investigations of Terms and Conditions of Public  
Utility Market-Based Rate Authorizations

Docket Nos. EL01-118-000  
and EL01-118-001

(Issued November 17, 2003)

BROWNELL, Commissioner, concurring:

1. We are adopting behavioral rules for market participants in the electric and natural gas markets. No one can question the good intention behind these behavioral rules. As I have stated before, if there are violations of our rules, regulations or policies, we must be willing to punish and correct. Concurrently, if there is misconduct by market participants that is intended to be anticompetitive, we must have the ability to remedy those market abuses.

2. Conversely, when we originally proposed behavioral rules, I had a number of concerns. I was concerned that the use of vague terms would create uncertainty and, thereby, undermine the good intentions of the rules. I feared that subsequent applications of the proposed behavior rules to real world actions could result in overly proscriptive "rules of the road" that will dampen business innovation and creative market strategies. The net effect would be less competition and the associated higher costs to consumers. I was concerned that we may be proposing a model that simply does not fit with the larger lessons we have learned in fostering competition over the past two decades, particularly in the gas market.

3. It is difficult to strike the right balance. I have carefully weighed the comments and believe the revisions and clarifications to the proposed behavioral rules achieve the appropriate balance. We clarify that these rules do not impose a “must offer” requirement. We revise the definition of manipulation to relate to actions that are “intended to or foreseeably could” manipulate markets. We add the exclusion that action taken at the direction of an RTO or ISO does not constitute manipulation.

4. Commenters also challenge the sufficiency of the term “legitimate business purpose” in distinguishing between prohibited and non-prohibited behavior. We clarify that transactions with economic substance, in which a seller offers or provides a service to a buyer where value is exchanged for value, are not prohibited behavior. Behavior driven by legitimate profit maximization or that serves important market functions is not manipulation. Moreover, I think it is important to recognize that scarcity pricing is the market response to a supply/demand imbalance that appropriately signals the need for infrastructure. For example, the high prices of 2000-2001 that reflected supply/demand fundamentals resulted in the first new power plants being constructed in California in ten years; price risk being hedged through the use of long-term contracting; and renewed efforts to correct a flawed market design.

5. We have also adopted measures that require accountability. A complaint must be brought to the Commission within 90 days after the calendar quarter that the manipulative action was alleged to have occurred. The 90-day time limit strikes an

appropriate balance between providing sufficient opportunity to detect violations and the market's need for finality. The Order also places a similar time limit on Commission action. As a matter of prosecutorial policy, the Commission will only initiate a proceeding or investigation within 90 days from when we obtained notice of a potential violation through either a hotline call; conversations with our enforcement staff; or notification from a market monitor.

6. While these rules are designed to provide adequate opportunity to detect, and the Commission to remedy, market abuses and are clearly defined so that they do not create uncertainty, disrupt competitive commodity markets or prove simply ineffective, competitive markets are dynamic. We need to periodically evaluate the impact of these behavior rules on the electric and natural gas markets. We have directed our Office of Market Oversight and Investigation to evaluate the effectiveness and consequences of these behavioral rules on an annual basis and include their analysis in the State of the Market Report.

Nora Mead Brownell