

103 FERC ¶ 61,347  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Investigation of Anomalous Bidding  
Behavior and Practices in the Western  
Markets

Docket No. IN03-10-000

ORDER REQUIRING DEMONSTRATION THAT  
CERTAIN BIDS DID NOT CONSTITUTE  
ANOMALOUS MARKET BEHAVIOR

(Issued June 25, 2003)

1. In this order, the Commission responds to the recommendations made by Staff in its investigation of the Western energy markets,<sup>1</sup> and evidence and comments submitted by market participants in Docket No. PA02-2-000, et al., concerning the bidding behavior and practices engaged in by participants in the short-term energy markets operated by the California Independent System Operator (Cal ISO) and the California Power Exchange (Cal PX), for the period May 1, 2000 to October 2, 2000.<sup>2</sup> Specifically, we respond to Staff's finding that bids for this period appear to have been excessive.
2. For the reasons discussed below, we will accept Staff's recommendations. We find that the Cal ISO's and Cal PX's Market Monitoring and Information Protocols

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<sup>1</sup>See Final Report on Company-Specific Separate Proceedings and Generic Reevaluations; Published Natural Gas Price Data; and Enron Trading Strategies: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Prices (Docket No. PA02-2-000, March 2003) (Western Markets Report). The Western Markets Report is available on the Commission's website.

<sup>2</sup>As discussed below, this period pre-dates the refund effective date established by the Commission in *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, et al., 96 FERC ¶ 61,120 at 61,506-11 (2000).

(MMIPs)<sup>3</sup> prohibit the bidding behavior at issue here. We also find that the remedy for these tariff violations, if found to exist, would be the disgorgement of any unjust profits attributable to these tariff violations, and may also include additional, appropriate non-monetary remedies as allowed under the Federal Power Act (FPA). As discussed below, the MMIP prohibits anomalous market behavior that departs significantly from normal behavior in a competitive market.<sup>4</sup> Specifically, the MMIP defines this prohibited behavior to include the withholding of generation capacity under circumstances in which it would normally be offered in a competitive market. In addition, the MMIP expressly prohibits "pricing and bidding patterns that are inconsistent with prevailing supply and demand conditions, e.g., prices and bids that appear consistently excessive for or otherwise inconsistent with such conditions."<sup>5</sup>

3. As noted by the Western Markets Report, the California restructuring required the three investor-owned public utilities (Pacific Gas & Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company) to procure all of their energy needs in the Cal PX and Cal ISO spot markets. During the relevant period, there was no market mitigation, in contrast to current conditions. Against this backdrop, we adopt the market-wide screen recommended by Staff, i.e., that all bids in the Cal ISO and Cal PX markets above \$250 per MW be considered excessive as a prima facie matter, and direct the Commission's Office of Market Oversight and Investigation (OMOI) to investigate this matter at the individual market participant level. Specifically, we direct OMOI to investigate all parties who bid in the Cal ISO and the Cal PX markets above the prima facie level of \$250 per MW to determine whether these parties may have violated the MMIP's prohibition against anomalous market behavior. Parties identified under this screen will be required to demonstrate to OMOI why their bidding behavior and practices did not violate the MMIP. We will instruct OMOI to report to the Commission regarding its findings and will issue further orders, as may be appropriate.

4. This order benefits customers by establishing procedures to address activities inconsistent with the Cal ISO and Cal PX tariffs during the period May 1, 2000 to October 2, 2000, consistent with due process.

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<sup>3</sup>Because both the Cal ISO and Cal PX have substantially similar MMIPs, we refer, here, for convenience, only to the Cal ISO's MMIP.

<sup>4</sup>See MMIP Section 2.1.1.5

<sup>5</sup>Id.

## Background

### Staff's Investigation of the Western Markets

5. In the Western Markets Report, Staff compared the input costs attributable to specific generators (primarily natural gas prices) with the spot market clearing prices for the period May 1, 2000 to October 2, 2000. Based on its review of this data, Staff concluded that the input costs attributable to certain entities for this period did not appear to support the high spot market clearing prices triggered by their bidding behavior. Staff noted, in this regard, that the clearing prices for this period reached the then-current purchase price caps (\$750/MW through July 1, 2000; \$500/MW through August 7, 2000; and \$250/MW thereafter). Staff concluded that the bid prices for this period appeared to have been excessively elevated solely for the purpose of raising prices, and that, as such, these bidding practices constituted a violation of the MMIP. Staff also concluded that bids at the \$250 level during August and September reflected an appropriate scarcity premium above marginal costs, *i.e.*, a proper allowance given the supply/demand imbalance in the Western markets.

### The California Refund Proceeding

6. On November 20, 2002, the Commission issued an order that allowed parties in Docket Nos. EL00-95-000, EL00-95-048, EL00-98-000 and EL00-98-042 to conduct additional discovery into alleged market manipulation by various sellers during 2000 and 2001, and specified procedures for adducing this information.<sup>6</sup> The Discovery Order allowed all parties to conduct discovery, review the material and submit directly to the Commission additional evidence and proposed new and/or modified findings of fact based upon proffered evidence that is either indicative or counter-indicative of market manipulation, no later than February 28, 2003.<sup>7</sup> On February 10, 2003, the Commission issued an order affording the parties an opportunity to respond to submissions made by

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<sup>6</sup>San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv., *et al.*, 101 FERC ¶ 61,186 (2002) (Discovery Order).

<sup>7</sup>*Id.* at P.27.

adverse parties.<sup>8</sup> The Rehearing Order allowed parties to file reply comments directly with the Commission by March 17, 2003, and allowed the reply comments to be filed by March 20, 2003.<sup>9</sup> These filings, which included sworn testimony and affidavits, are referred to as the "100 Days Evidence."

## Discussion

### A. The MMIP's Provisions Concerning Anomalous Market Behavior

7. Staff, in the Western Markets Report, interprets the MMIP as "rules of the road" which the Commission may enforce. Staff also interprets the MMIP as barring the type of bidding behavior discussed herein. Staff explains that the MMIP enumerates objectionable practices, authorizes the Cal ISO to impose sanctions and penalties (or to refer matters to the Commission for appropriate sanctions or penalties<sup>10</sup>), and was made a part of the Cal ISO and Cal PX tariffs in 1998, *i.e.*, prior to the period at issue here.

8. In addressing the applicability of the MMIP in this case, some commenters argued that: (1) the MMIP was intended to provide direction to the Cal ISO and not be a standard by which the Commission prosecuted market participants' conduct; (2) the MMIP does not expressly bar the bidding behavior addressed herein; and (3) the Commission cannot hold market participants responsible for the bids they made when they have not had fair notice that bids of this sort were prohibited. Other commenters, in contrast, supported Staff's interpretation of the MMIP.<sup>11</sup>

9. We find that the MMIP puts market participants on notice regarding their rights and obligations in the marketplace. It serves as the rules of the road for market participants. It also contemplates that these rules will be enforced by the Market Surveillance Unit, in the form of monitoring and reporting, or by the appropriate body or

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<sup>8</sup>San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv., *et al.*, 102 FERC ¶ 61,164 (2003), *reh'g pending* (Rehearing Order).

<sup>9</sup>San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv., *et al.*, 102 FERC ¶ 61,194 (2003) (February 24 Order).

<sup>10</sup>See MMIP Section 7.3.

<sup>11</sup>*E.g.*, the California Parties, which include the California Attorney General and the California Public Utilities Commission, among others.

bodies (including this Commission), in the form of corrective actions. We also find that the MMIP prohibits non-competitive bidding. In sum, the Western Markets Report finds, and we agree, that market participants cannot reasonably argue that they were not on notice that the bidding behavior outlined here and discussed further below would be in violation of the Cal ISO and Cal PX tariffs' prohibition against anomalous bidding behavior.

10. The MMIP is one of several protocols which the Commission required the Cal ISO and the Cal PX to incorporate into their filed tariffs. The Objectives, Section 1.1 of the MMIP, outlines its underlying purpose:

This Protocol (MMIP) sets forth the workplan and, where applicable, the rules under which the ISO will monitor the ISO markets to identify abuses of market power, to ensure to the extent possible the efficient working of the ISO Markets immediately upon commencement of their operation, and to provide for their protection from abuses that have the potential to undermine their effective functioning or overall efficiency in accordance with Section 16.3 of the ISO tariff.<sup>[12]</sup>

11. While the Commission's role in enforcing the MMIP may be triggered by the referral procedures outlined therein, the Commission also possesses the authority to enforce a rate schedule on file even in the absence of a referral. Clearly, the Commission is authorized to enforce a tariff with or without the assistance of a complaint or a referral.<sup>13</sup>

12. Part 2 of the MMIP specifies what are termed "Practices Subject to Scrutiny." Among these practices is "anomalous market behavior," as defined at Section 2.1.1 of the MMIP:

"Anomalous market behavior" . . . is . . . behavior that departs significantly from the normal behavior in competitive markets that do not require continuing regulation or as behavior leading to unusual or unexplained market outcomes. Evidence of such behavior may be derived from a number of circumstances, including:

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<sup>12</sup>MMIP Section 1.1.

<sup>13</sup>16 U.S.C. §§ 824d, 824e (2000).

withholding of Generation capacity under circumstances in which it would normally be offered in a competitive market; [and]

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pricing and bidding patterns that are inconsistent with prevailing supply and demand conditions, e.g., prices and bids that appear consistently excessive for or otherwise inconsistent with such conditions.<sup>[14]</sup>

13. As the bidding behavior identified above and discussed further below falls within the MMIP's provisions identifying anomalous market behavior, we find that bidding behavior of this sort violates the Cal ISO's and the Cal PX's tariffs. To the extent we identify any such conduct on the part of market participants (and to the extent such behavior cannot be defended as legitimate<sup>15</sup>), we will require that all such unjust profits for the period May 1, 2000 to October 2, 2000 be disgorged in their entirety. We will also consider any additional non-monetary remedies which may be appropriate, such as, for example, revocation of market-based rate authority and revisions to market participants codes of conduct.

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<sup>14</sup>Section 2.1.1.5 of the MMIP further provides that:

The Market Surveillance Unit shall evaluate on an ongoing basis, whether the continued or persistent presence of such circumstances indicates the presence of behavior that is designed to or has the potential to distort the operation and efficient functioning of a competitive market, e.g., the strategic withholding and redeclaring of capacity, and whether it indicates the presence and exercise of market power or of other unacceptable practices.

<sup>15</sup>In this context, the Commission considers legitimate business behavior to be actions consistent with appropriate behavior in a competitive market, i.e., actions taken to further a firm's business objectives but not involving manipulative, illegal, or otherwise anticompetitive acts. Engaging in manipulation, for example, in order to maximize profits, is not legitimate business behavior.

**B. Commission Authority with Respect to the Period Prior to October 2, 2000**

14. In our July 25 and November 1, 2001 orders in the California Refund Proceeding,<sup>16</sup> we established a refund effective date (October 2, 2000) concerning the allegations at issue in that proceeding, based on the evidence available at that time and the refund limitations set forth in section 206 of the Federal Power Act (FPA).<sup>17</sup> We did not include within the scope of that proceeding, conduct relating to the period at issue here, *i.e.*, for the period May 1, 2000 to October 2, 2000. In doing so, however, we noted that the Commission could take action to address earlier periods if, during those earlier periods, a seller did not charge the filed rate or violated the terms and conditions of a filed tariff.<sup>18</sup> Thus, with respect to disgorgement of unjust profits for the period prior to the October 2, 2000 refund effective date, the Commission can order disgorgement of additional monies above the refunds ordered in the California Refund Proceeding if we find violations of the Cal ISO and Cal PX tariffs.

**C. Bidding Patterns in the Western Markets**

15. In addition to Staff's analysis of bidding in the Western Markets Report, we have reviewed the testimony by witnesses submitted in the 100 Days Evidence. Based on our review and analysis of this evidence, we adopt the \$250 per MW screen recommended by Staff to identify, as a *prima facie* matter, anomalous bidding behavior and practices in the Western market for the period May 1, 2000 to October 2, 2000. Entities who submitted bids in excess of \$250 per MW in the Cal ISO and Cal PX markets will be investigated

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<sup>16</sup>San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services, *et al.*, 96 FERC ¶ 61,120 at 61,506-511 (July 25 Order), order on clarification and reh'g, 97 FERC ¶ 61,275 (2001) (December 19 Order); San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al.*, 93 FERC ¶ 61,121 (2000).

<sup>17</sup>16 U.S.C. § 824e (2000).

<sup>18</sup>96 FERC at 61,507-08, citing Washington Water Power Company, 83 FERC ¶ 61,282 (1998). See also Jack J. Gynsburg v. Rocky Mountain Natural Gas Company, 90 FERC ¶ 61,247 at 61,825-26, reh'g denied, 93 FERC ¶ 61,180 at 61,587 (2000); Public Service Company of Colorado, 85 FERC ¶ 61,146 at 61,588 (1998).

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and will be required to demonstrate why such bids did not violate the MMIP, i.e., to what extent their bidding behavior and practices constituted legitimate business behavior.

16. We instruct OMOI to investigate these matters and to report back to the Commission regarding its investigation. On the basis of this report, the Commission will issue further orders, as may be appropriate.

The Commission orders:

OMOI is hereby directed to investigate anomalous bidding behavior and practices in the Western markets, as discussed in the body of this order.

By the Commission. Commissioner Massey concurred in part and dissented in part  
with a separate statement attached.

( S E A L )

Magalie R. Salas,  
Secretary.

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Docket No. IN03-10-000

(Issued June 25, 2003)

MASSEY, Commissioner, concurring in part and dissenting in part:

With this order, the Commission takes another step toward addressing all of the factors that played a part in driving Western electricity prices to extraordinary levels in 2000 and 2001. Our staff report concluded that anomalous bidding behavior played a role in driving those high prices and today we take an important step in dealing with such behavior. I support today's order, and commend Chairman Wood for his leadership in attempting to come to grips with the bad behavior in the ISO and PX markets during the Western crisis.

There is one aspect of today's order, however, that does not delve deeply enough to remedy prices falling outside a zone of reasonableness. The order adopts a \$250 screen to identify questionable bids. This is too high. The staff's Western Markets Report indicates that a \$250 bid would far more than compensate a relatively inefficient generating unit for its incurred and capital costs.<sup>1</sup> Yet the report recommends, and today's order adopts, a screen of \$250 on the basis that such a bid could include a scarcity premium to reflect the imbalance of supply and demand. I am concerned that this is too generous and may sanction inappropriate behavior by bidders.

The bids at issue in this investigation were made into an auction market that was settled at a single market clearing price. A single clearing price is a basic feature of imbalance market design that the Commission promotes and has approved in a number of cases. I have supported this market design feature primarily because it is based upon the

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<sup>1</sup>Western Markets Report at VI-53.

theory that sellers will submit bids that reflect their marginal costs. This is because sellers that are dispatched collect the clearing price even if they bid lower, and those that bid more than their costs risk not being called upon. A seller with costs below the clearing price can apply that margin to capital cost recovery or profit. Thus, according to the theory, prospective sellers have no incentive to bid other than their costs. A benefit of sellers bidding their costs is that the most efficient sellers will be selected first.<sup>2</sup> Indeed, our April 26, 2001 California market mitigation order found that marginal costs reflect what generators would bid in a competitive market.<sup>3</sup> These benefits are lost if bidders include additional dollars based on their perception of a scarcity premium.

Thus, I would prefer to use some approximation of bidders' full marginal costs, plus a capital cost component, as a screen for anomalous bidding behavior in this instance. I do not think it is appropriate to allow a scarcity premium for bids under these circumstances. Sellers were bidding into a market with little or no demand response where shortages were easily anticipated if not actually announced. Moreover, there is still the outstanding issue of whether the shortages were contrived through the physical withholding of generation. Under these circumstances, I do not believe a scarcity premium in bids is appropriate. I would prefer a screen closer to marginal costs, and then the Commission could evaluate explanations regarding why bids were higher.

There is also one aspect of today's order on which I am dissenting. I would not limit the monetary penalty for tariff violations to disgorgement of unjust profits. Market manipulation can raise the single market clearing price paid by all market participants and collected by all sellers. The Federal Power Act requires that all rates and charges be just and reasonable. Where the market has been manipulated so as to affect the market clearing price, that price is not just and reasonable and is therefore unlawful. Simply requiring that bad actors disgorge their individual profits does not make the market whole because all sellers received the unlawful price caused by the manipulation. The narrow remedy of profit disgorgement is not an adequate remedy for the adverse effect of the bad behavior on the market price, and may not be an adequate deterrent to future behavior. The appropriate remedy may be that the manipulating seller makes the market

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<sup>2</sup>See, for example, SMD NOPR, 100 FERC ¶ 61,138 (2002) at note 118; Midwest Independent Transmission System Operator, Inc, 102 FERC ¶ 61,196 (2003) at P32; and Cleco Power LLC et al., 103 FERC ¶ 61, 272 (2003) at P67.

<sup>3</sup>San Diego Gas & Electric Company, 95 FERC ¶ 61,115 (2001) at 61,362 to 363.

whole.<sup>4</sup> Unfortunately, today's order appears to take this remedy off of the table. I would prefer

to wait to see the extent of harm that specific behaviors caused before addressing the remedy issue.

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

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William L. Massey  
Commissioner

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<sup>4</sup>The Commission has accepted the make the market whole remedy as part of a settlement for withholding generation from the California PX market. See 102 FERC ¶ 61,108 (2003).