

103 FERC ¶ 61,349

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 SEEKING COMMENTS ON PROPOSED REVISIONS  
TO MARKET-BASED RATE TARIFFS AND AUTHORIZATIONS

(Issued June 26, 2003)

1. In an order dated November 20, 2001, 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 to include a provision prohibiting the seller from engaging in anticompetitive behavior or the exercise of market power.<sup>2</sup> This market behavior standard, we indicated, was intended to establish a clear benchmark governing market participant conduct, with the penalties for violations clearly spelled out.
2. Commenters in this proceeding argued that the Commission's proposed tariff provision was overly-proscriptive or vague and would, if implemented, create uncertainty in the marketplace. Others argued that the tariff provision did not go far enough in protecting against the unjust and unreasonable rates that may result from anticompetitive behavior or the exercise of market power. To address these concerns, Commission Staff convened a public conference in this proceeding to determine whether, and how, the tariff provision proposed in the November 20 Order could, or should, be modified.
3. In the meantime, in conjunction with its investigation of the Western energy markets, in Docket No. PA02-2-000, Commission Staff issued its Final Report on Price

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<sup>1</sup>16 U.S.C. § 824e (2000).

<sup>2</sup>97 FERC ¶ 61,220 (2001) (November 20 Order).

Manipulation in Western Markets (Western Markets Report).<sup>3</sup> Among other things, Staff recommended that the Commission condition all electric market-based rate tariffs and authorizations (and all natural gas blanket marketing certificates) to prohibit a number of specifically-enumerated transactions and market behaviors. Staff also recommended that the Commission provide for the imposition of penalties for violations of these market behavior rules.

4. Since our November 20 Order, the Commission has been informed not only by the comments received from the public in this proceeding, but also by what we have learned about the types of behavior that occurred in the Western markets during 2000 and 2001. We also have gained additional experience in other competitive markets, particularly those with organized spot markets in the East.

5. As part of our ongoing responsibility to provide regulatory safeguards to ensure that customers are protected from potential market abuses, we believe it is important to take steps within our statutory authority that balance 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 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. A stable marketplace with clearly defined rules benefits both customers and market participants and creates an environment that will attract much-needed capital.

6. Based on these three objectives, we propose to modify the tariff provision set forth in the November 20 Order by identifying more precisely and comprehensively than we did in the November 20 Order the transactions and practices that would be prohibited under sellers' market-based rate tariffs and authorizations. We propose six specific rules relating to: (1) unit operation; (2) market manipulation; (3) communications;

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<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). The Western Markets Report is available on the Commission's website.

(4) reporting; (5) record retention; and (6) related tariffs.<sup>4</sup> Should a seller be found to have engaged in the transactions or behavior prohibited under our proposed market behavior rules, it would be subject to disgorgement of unjust profits obtained in contravention of the seller's tariff, and appropriate non-monetary remedies such as revocation of seller's market-based rate authority and revisions to seller's code of conduct. We seek comments on these proposed market behavior rules and related matters, as discussed below.<sup>5</sup>

7. The balance struck in formulating these proposed market behavior rules has presented a difficult task. We have been required to make judgments, for example, which necessarily include trade-offs – between broad and unlimited rights of parties to allege violations and obtain financial remedies, on the one hand, while at the same time providing transaction finality to sellers and the market in general. While our proposal represents our best judgment of the proper balance between these competing interests, we hope and expect that, in addition to the specifics of our proposal, commenters will fully address whether we have achieved the appropriate balance.

8. We also note that the market behavior rules we are proposing would apply to any market-based sale, whether in the bilateral market or in an organized market, i.e., in the markets administered by a regional transmission organization (RTO) or by an independent system operator (ISO). These market behavior rules would be intended to complement any RTO or ISO tariff conditions and market rules that may apply to sellers in these markets.

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<sup>4</sup>In a Notice of Proposed Rulemaking being issued today, in Docket No. RM03-10-000, we are also proposing, consistent with the recommendations made by Staff in the Western Markets Report, 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.

<sup>5</sup>Because the proposals made herein would have the effect of revising sellers' market-based rate tariffs, and thus would not constitute an amendment to the Commission's regulations, we are proposing to proceed in this forum rather than in a rulemaking proceeding governed by the Administrative Procedures Act, 5 U.S.C. § 553 (2000). However, in doing so, we are mindful of the generic effect that our proposal will have on the industry as a whole, and the importance of seeking full public input regarding our proposal. In this regard, we seek comments from all interested entities on a broad range of issues, as discussed below, and are directing that this order be published in the Federal Register.

## Background

### The November 20 Order

9. In the November 20 Order, we instituted a proceeding pursuant to Section 206 of the FPA, in which we proposed to condition our grant of market-based rate authority to public utilities that sell electric energy and ancillary services at wholesale in interstate commerce, by expressly prohibiting sellers from engaging in anticompetitive behavior or abuses of market power.<sup>6</sup> We found that the implementation of this market behavior standard was made necessary, in part, by the lessons learned from the California energy crisis and our on-going investigation of that market in the California Refund Proceeding.<sup>7</sup>

10. In a series of orders issued in the California Refund Proceeding, we had determined, prior to our issuance of the November 20 Order, that the electric market structure and market rules for wholesale sales of electric energy in California were seriously flawed, and that these market flaws had created an environment ripe for anticompetitive conduct and the abuse of market power. We noted in the November 20 Order that as a response, we had, among other things, established market behavior conditions applicable to the Western markets, including refund liability, on sellers' market-based rate authority to prevent anticompetitive bidding behavior.<sup>8</sup>

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<sup>6</sup>The November 20 Order proposed to include the following provision in all market-based rate tariffs and authorizations: "As a condition of obtaining and retaining market-based rate authority, the seller is prohibited from engaging in anticompetitive behavior or the exercise of market power. The seller's market-based rate authority is subject to refunds or other remedies as may be appropriate to address any anticompetitive behavior or exercise of market power." See November 20 Order, 97 FERC at 61,976.

<sup>7</sup>See, e.g., San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Service, et al., 97 FERC ¶ 61,275 (2001).

<sup>8</sup>November 20 Order, 97 FERC at 61,975, citing San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Service, et al., 95 FERC ¶ 61,115, order on reh'g, 95 FERC ¶ 61,418 (2001).

11. In the November 20 Order, however, we also noted that this potential for market manipulation was not limited to the California market.<sup>9</sup> In fact, the potential for market abuse and the exercise of market power may exist in any region where the evolution towards a competitive market is not yet complete; or where the design structure of the market is otherwise ill-equipped to promote competition; or where the supply/demand imbalance causes the market to be in disequilibrium.<sup>10</sup> In the November 20 Order, therefore, we proposed to apply to all public utilities authorized to sell energy and ancillary services at market-based rates, the same conditions we had applied to market-based rate sellers in the western markets.

### **Hearing Procedures and Responsive Pleadings**

12. The November 20 Order established paper hearing procedures to address the Commission's proposed tariff provision, with interested entities invited to file comments and reply comments. Numerous responsive pleadings were filed. In addition, a public conference was convened in this proceeding on March 11, 2002, to discuss issues raised in the comments and reply comments. Comments on the technical conference were filed on March 22, 2002.

### **Staff's Investigation of Market Manipulation in the Western Markets**

13. Commission Staff addressed a broad range of market power issues and the need for market behavior rules, in its investigation of the Western energy markets, in Docket No. PA02-2-000.<sup>11</sup> In Staff's Initial Report, issued in August 2002, Staff made a number of findings regarding, among other things, the possible misconduct by Enron Corporation (Enron) and its affiliates, and the use, by Enron and its affiliates, of the so-called Enron

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<sup>9</sup>Id. at 61,975-76.

<sup>10</sup>In addition, sellers may have the opportunity to exercise market power even in markets which are typically (and on most occasions) competitive. For example, extreme supply or demand conditions to which the market cannot quickly adapt, such as the loss of significant hydropower capacity because of drought, or force majeure events such as a major transmission line outage could provide opportunities to exercise market power even in a market that is normally workably competitive.

<sup>11</sup>Staff's investigation was initiated pursuant to our February 13, 2002 order in Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, 98 FERC ¶ 61,165 (2002).

trading strategies.<sup>12</sup> These trading strategies, Staff found, included efforts to game the market in ways that were either fraudulent or otherwise anticompetitive. Moreover, Staff found that similar trading strategies were being utilized by a broad cross-section of the industry.

14. Subsequently, in the Western Markets Report, Staff recommended that the Commission condition all electric market-based rate tariffs and authorizations and all natural gas blanket marketing certificates on specific market behavior rules.<sup>13</sup> Staff proposed that market-based rate sellers be required by their tariffs to: (1) provide complete, accurate, and honest information to any entity that publishes price indices; (2) retain all relevant data and information needed to reconstruct a published price index for a period of 3 years; (3) explicitly prohibit the use of false information as a condition for granting all market-based rate authorizations; (4) require that data sent to firms publishing price indices be provided by the risk management office of the company, not the trading desk or a trader, and be certified by the chief risk officer; (5) ban any form of prearranged wash trading and prohibit the reporting of any affiliate trading activities through industry indices; (6) require that sellers who use trading platforms use only those trading platforms that agree to provide the Commission with full access to trade reporting and order book information for the trading systems and agree to adhere to appropriate monitoring requirements; and (7) prohibit the submission of false information or the omission of material information to the Commission or to an entity such as an independent system operator, a regional transmission organization, or an approved market monitor.

## Discussion

### Procedural Issues

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<sup>12</sup>See Initial 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 Gas Prices, Docket No. PA02-2-000 (August 2002).

<sup>13</sup>The Final Report also recommended that several entities participating in the California market (including Enron) be required to show cause why their authority to sell power at market-based rates should not be revoked by the Commission in light of their apparent involvement in market manipulation and gaming activities. Orders directed to these issues were subsequently issued by the Commission on March 26, 2003. See Enron Power Marketing, Inc., et al., 102 FERC ¶ 61,316 (2003); Reliant Energy Services, Inc., et al., 102 FERC ¶ 61,315 (2003).

15. A number of entities request rehearing of the November 20 Order. However, rehearing may not be sought in this case until the Commission issues a final decision or other final order.<sup>14</sup> Because the November 20 Order initiated an investigation and thus was not a final order, we will not consider requests for rehearing of the November 20 Order. However, we will treat these requests as comments to the degree they are relevant to our current proposal.

### **Proposed Tariff Revisions**

16. Consistent with the findings and recommendations of the Western Markets Report and the comments filed in this proceeding, we propose new market behavior rules applicable to all market-based rate tariffs and authorizations. As set forth in the Attachment to this order, these market behavior rules would prohibit market manipulation and more clearly outline sellers' responsibilities and duties with respect to communications to regulatory authorities and market operators. Should a seller be found to have engaged in the transactions or behavior prohibited under our proposed market behavior rules, it would be subject to disgorgement of unjust profits obtained in contravention of the seller's tariff, and appropriate non-monetary remedies such as revocation of seller's market-based rate authority and revisions to seller's code of conduct.

17. As noted above, in proposing these market behavior rules we have attempted to strike a careful balance. On the one hand, it is essential, for all the reasons outlined in the November 20 Order and in the Western Markets Report, that our market behavior rules be clear and enforceable. Market conduct which is anticompetitive or which constitutes an abuse of market power must be prohibited and made subject to remedial action under the circumstances outlined herein. On the other hand, transactions and practices which are consistent with the normal operation of supply, demand, and true scarcity, or which otherwise have a legitimate business purpose, should neither be discouraged nor impeded. Further, while our proposal is designed to give the Commission and interested parties an enhanced ability to undertake effective enforcement and to require appropriate remedies, we understand that market participants need some level of certainty, that is, they need to know that they will not be exposed to open-ended uncertainty. Our proposal attempts to balance these two valid concerns by proposing appropriately-tailored complaint procedures and by providing clarity regarding sellers' potential liability.<sup>15</sup>

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<sup>14</sup>See Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2003).

<sup>15</sup>See supra PP. 37-42 (complaint procedures and scope of liability).

**Market Behavior Rule # 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 rules and regulations of the applicable power market.*

18. The integrity of an organized market operated by an RTO or ISO and the integrity of other markets as well, depends in part upon generators and other sellers fully and accurately providing all information to market operators and complying with market rules, particularly those relating to bidding. In Market Behavior Rule # 1, therefore, the Commission proposes 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 the rules and regulations of the applicable power market. This requirement contemplates that sellers will follow these rules and regulations by providing complete and honest information, as may be required.<sup>16</sup> Market Behavior Rule # 1 is consistent with our view that ex ante rules are superior to ex post regulatory action.

19. While we understand that market participants may become subject to additional requirements through tariff service agreements and other market participation agreements, we believe that a specific requirement in each seller's market-based rate tariff addressing unit operation issues is necessary in order to give the Commission and interested parties direct remedial authority for violations that may not exist without such a condition. We request comment on the inclusion of this condition in market-based tariffs.

**Market Behavior Rule # 2: Market Manipulation**

*Actions or transactions without a legitimate business purpose which manipulate or attempt to manipulate market prices, market conditions, or market rules for electric energy, or result in market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand, are prohibited. Prohibited actions and transactions include, but are not limited to: (A) 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 (sometimes called "wash trades"); (B) transactions predicated on submitting false*

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<sup>16</sup>We note that EPSA, in its code of ethics and sound trading practices, has developed a standard which includes elements of Market Behavior Rule # 1.



*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); (C) transactions in which an entity first creates artificial congestion and then "relieves" such artificial congestion; (D) collusion with another party for the purpose of creating market prices at levels differing from those set by market forces; and (E) 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.*

20. Our reliance upon 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. 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.

21. In formulating the conditions to be added to public utility sellers' tariffs, the Commission is fulfilling its obligation to appropriately monitor markets and is thus taking steps to ensure that market-based rates remain within the zone of reasonableness required by the FPA. In a market-based rate regime, this means that public utility sellers will not be permitted to exercise market power or take anti-competitive actions that may increase market prices and that the Commission will take appropriate remedial steps. Such steps may include market rules designed to prevent exercises of market power as well as conditions placed on market-based rate authorizations to prohibit conduct that adversely affects competitive market outcomes.<sup>17</sup>

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<sup>17</sup>The Court of Appeals for the D.C. Circuit has held that, while the Commission "enjoys substantial discretion in ratemaking determinations . . . by the same token, this discretion must be bridled in accordance with the statutory mandate that the resulting rates be 'just and reasonable.'" *Farmers Union Cent. Exch. Inc. v. FERC*, 747 F.2d 1486 at 1501 (D.C. Cir. 1984). In addition, the regulatory regime itself must contain some form of monitoring to ensure that rates remain within a zone of reasonableness and to check rates that depart from this zone. *Id.* at 1509. See also *Louisiana Energy and Power Authority v. FERC*, 141 F.3d 364 (D.C. Cir. 1998); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993).

22. Accordingly, we propose in Market Behavior Rule # 2 to prohibit activities that adversely affect competitive outcomes, that is, that result in rates that do not reflect legitimate market forces. Such rates would fall outside the zone of reasonableness.<sup>18</sup> In making this proposal, we note that just and reasonable rates created through competitive markets is our goal. We believe that by providing further clarity concerning prohibited actions and transactions, and by undertaking judicious enforcement of these standards, we will help to enhance confidence in, and the integrity of, our jurisdictional markets for both customers and market participants.

23. In crafting Market Behavior Rule # 2, we have also attempted to provide specificity by including a non-exclusive list of prohibited activities that illustrates the types of activities that adversely affect competitive market outcomes. However, we have also included a generic standard which will allow us to take remedial action if we discover additional activities of a seller taken in contravention of our market behavior rules affecting the justness and reasonableness of rates. In the event that Staff, or a third party in a timely complaint, demonstrates that a transaction or behavior not expressly prohibited in our market behavior rules appears to be in violation of this rule (*i.e.*, that a given transaction or behavior is causing prices to reflect outcomes not reflective of market forces), we will require the identified seller to show cause why it should not be required to disgorge unjust profits obtained through such transaction or behavior, or and be subject to appropriate non-monetary remedies. In evaluating responses to such show cause orders, we will take into account such matters as whether the seller can establish a legitimate business purpose consistent with prices set by market forces relative to its conduct.<sup>19</sup>

24. Our market behavior rules would 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" test as required by the contract). Rather, any party seeking contract reformation or abrogation

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<sup>18</sup>In prohibiting transactions such as those involving false congestion, the Commission does not intend to prohibit transactions taken consistent with market rules in ISO or RTO markets such as virtual bidding or day ahead markets where "simulated" congestion may be reflected in pricing as part of market design.

<sup>19</sup>The Commission considers a legitimate business purpose to be an action consistent with behavior in a competitive market which is taken to further a firm's business objectives without engaging in manipulative, illegal, or otherwise anticompetitive acts. Engaging in manipulation, for example, in order to maximize profits, is not a legitimate business purpose.

based on a violation of one or more of the market behavior rules 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.

25. Finally, in undertaking our enforcement decisions, we will focus on the best outcome for assuring just and reasonable rates in our jurisdictional markets. In some instances, significant remedial action may be warranted. In other instances, we may use a specific set of facts and circumstances to clarify our requirements for acceptable public utility activities. As such, it is our expectation that through this proposed tariff revision, we will appropriately balance our need to remedy anticompetitive behavior with the legitimate needs of market participants for clear rules. We seek comment on these issues and any other issues of concern relating to Market Behavior Rule # 2.

### **Market Behavior Rule # 3: Communications**

*Seller will provide complete, accurate, and factual information, and not submit false or misleading information, or omit material information, in any communications with the Commission, market monitors, regional transmission organizations, independent system operators, or similar entities.*

26. In the Western Markets Report, Staff proposes that all market-based rate tariffs include a specific prohibition against the submission of false information or the omission of material information to the Commission or to an entity such as an ISO, an RTO, or an approved market monitor.<sup>20</sup>

27. Based on Staff's recommendation, we propose and seek comment on Market Behavior Rule # 3. Specifically, we seek comment on whether this proposed rule would be sufficient in its scope and breadth to cover any and all matters relevant to

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<sup>20</sup>See Western Markets Report at ES-17. In this regard, EPSA, in its code of ethics and sound trading practices, requires its members to "provide market and transaction information to regulators and market monitors in compliance with all applicable rules and requirements and [to] continue to cooperate with regulators and market monitors as reasonably necessary to assist in their understanding of market operations."

wholesale markets, including maintenance and outage data, bid data, price and transaction information, and load and resource data. In addition, we seek comment on whether this remedial authority would serve as a useful and appropriate tool in ensuring just and reasonable rates.

#### **Market Behavior Rule # 4: Reporting**

*To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide complete, accurate and factual information to any such publisher. Seller shall notify the Commission of whether it engages in such reporting for all sales. In addition, the seller shall adhere to such other standards and requirements for price reporting as the Commission may order.*

28. In the Western Markets Report, Staff proposes that all electric market-based rate tariffs and authorizations be conditioned to expressly require that sellers provide complete, accurate, and honest information to any entity that publishes price indices and to require that data sent to firms publishing price indices be provided by the risk management office of the company, not the trading desk or a trader, and be certified by the chief risk officer.<sup>21</sup>

29. Based on Staff's recommendation, we propose and seek comment on Market Behavior Rule # 4. In the Western Markets Report, Staff found that the markets for natural gas and electricity in California are inextricably linked, that there were dysfunctions in these markets that fed off each other, and that the dysfunctions in the natural gas market appear to have stemmed, at least in part, from efforts to manipulate price indices compiled by trade publications – by fabricating trades, inflating the volume of trades, omitting trades, and adjusting the price of trades.<sup>22</sup>

30. Staff further found that the predominant motives for reporting false information were to influence reported gas prices, to enhance the value of financial positions or purchase obligations, and to increase reported volumes to attract participants by

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<sup>21</sup>Id. Similarly, 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>22</sup>Id. at III-2 (noting that, to date, five major traders – Williams, Dynegy, AEP, CMS, and El Paso Merchant Energy – have admitted that their employees falsified information provided to compilers of natural gas price indices).

creating the impression of more liquid markets. In light of these findings, we seek comment on whether Market Behavior Rule # 4, 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.

31. With regard to standards and requirements for price reporting, on April 24, 2003, we convened a public conference in Docket No. AD03-7-000, together with the Commodity Futures Trading Commission (CFTC), to consider natural gas price formation issues, including the development of alternative index formation models. At that conference and from comments submitted thereafter, we have received valuable input helping us refine the options available. To that end, we have conducted a follow-up conference, also with CFTC participation, for both natural gas and electricity indices.

32. While we are considering requiring jurisdictional entities to report transactions to an entity responsible for index creation, we note that our efforts towards resolution of this issue will be in Docket No. AD03-7-000. Market Behavior Rule # 4 states that sellers will be required to adhere to other standards or requirements as the Commission may order. Based upon our review of the record developed in Docket No. AD03-7-000, we may issue such an order to be implemented at the same time as the market-based tariff rules proposed herein.

#### **Market Behavior Rule # 5: Record Retention**

*Seller will retain all data and information necessary for the reconstruction of energy or energy products prices it charges, or the prices it reports for use in published price indices, for a period of three years.*

33. In the Western Markets Report, Staff recommends 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>23</sup>

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<sup>23</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."

34. Based on Staff's recommendation, we propose and seek comment on Market Behavior Rule # 5. In the Western Markets Report, Staff found that companies had little, if any, formal procedures in place to ensure the accuracy of the data reported to the trade press. Staff also found that companies had reported inaccurate information. Staff found that these inaccuracies were attributable to unstructured or nonexistent processes for reporting (e.g., taking the simple arithmetic average of the high and low trades), making up trades to come up with an average that was the midpoint of the traders' perceived range, and entering fictitious trades (both prices and volumes) to replicate prices reported to trading platforms. We seek comments on whether Market Behavior Rule # 5, as proposed, would ensure that companies adopt suitable retention policies that would permit the Commission and interested entities to better monitor these transactions and practices, to the extent necessary and appropriate.

#### **Market Behavior Rule # 6: Related Tariffs**

*Seller shall not violate or collude with another party in actions that violate Seller's code of conduct or Order No. 889 standards of conduct.*

35. In the Western Markets Report, Staff found that sellers had failed to abide by their market-based rate codes of conduct and their Order No. 889 standards of conduct. These tariff provisions, among other things, require the functional separation of transmission and wholesale merchant personnel. In one case, Staff found that a power marketer used a third party to circumvent the Commission's prohibition on affiliate sales.<sup>24</sup>

36. To better monitor and deter these tariff violations, we propose and seek comment on Market Behavior Rule # 6. Specifically, we seek comment on whether the standard as proposed is 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. We seek comment on whether this compliance rule would be an effective way for the Commission to better ensure that the conduct of public utilities is consistent with the public interest.

#### **Complaint Procedures and Limitations on Disgorgement Liability**

37. As noted above, in crafting the market behavior rules proposed herein, we have attempted to balance our interest in providing adequate certainty for market participants

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<sup>24</sup>See also Idaho Power Company, et al. (Docket No. IN03-9-000).

to encourage fair, robust competition, with our equal commitment to protecting customers from the abuses of market power and other anticompetitive behavior. Looking ahead, we want to formalize both our market rules and their consequences for greater market certainty. Accordingly, we further seek comment on the procedural limitations proposed below.

38. First, we propose 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 such a remedy be made no later than 60 days after the end of the calendar quarter in which the violation is alleged to have occurred. If a market participant can show that it did not know and should not have known of the behavior which forms the basis for the complaint, within the period proscribed above, then the 60-day period will run from the time when the market participant knew or should have known of the behavior. In addition, we propose to restrict remedies sought in market participant complaints to the specific transactions which are the subject of these complaints.<sup>25</sup>

39. For example, the backward-looking scope of remedial action due to an allegation made by a market participant concerning a violation of the behavioral rules contained in a market-based rates tariff would be limited to the period reaching to the beginning of the calendar quarter referenced above. Thus, an allegation could be made up to 60 days after March 31 of a calendar year seeking disgorgement of unjust profits for a transaction taking place in the quarter ending March 31. Any other action taken by the Commission on the basis of such allegation would be prospective only.

40. These time limits will apply to complaints initiated by market participants and not to those initiated by the Commission. The Commission has broad remedial authority to act in the event of violations of statutory or regulatory requirements or rules in applicable tariffs.<sup>26</sup> Where there is a violation of the market behavior rules that are adopted for all new and existing market-based rate tariffs and authorizations, the Commission is proposing to retain the full scope of its authority to provide remedies upon its own motion. Thus, the Commission and its staff will not be subject to the time limitation on allegations of tariff violations. The Commission believes that this properly balances the

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<sup>25</sup>Such claims, moreover, would be required to comply with the Commission's revised complaint procedures in 18 C.F.R. § 385.206 (2003). See Lester C. Reed v. Georgia Power Co., 94 FERC ¶ 61,100 (2001).

<sup>26</sup>San Diego Gas & Electric Co., 96 FERC ¶ 61,120 at 61,507-08 (2001), citing Washington Water Power Co., 83 FERC ¶ 61,282 (1998).

interest of market participants in finality with the need to be able to take action against tariff violations.

41. Other limitations proposed by commenters in this proceeding have not been included in our proposal. For example, while several commenters have argued that sales into markets with Commission-approved market monitoring and mitigation should be exempt from any market behavior rules approved herein we are not including this limitation in our proposal. The findings made by Staff in the Western Markets Report illustrate that organized, bid-based markets, even those with approved market monitoring and mitigation procedures, remain vulnerable to anticompetitive behavior and the exercise of market power. Accordingly, Staff thus recommended that market behavior rules be adopted for all markets without exception.

42. Other commenters have suggested that entities such as power marketers and small generators should be exempted from our market behavior rules because entities such as these are unable to exercise market power in the markets in which they operate. We disagree. In the Western Markets Report, Staff found that power marketers and small generators can and have engaged in practices and transactions which our proposed market behavior rules are designed to prohibit. Accordingly, we propose to apply our market behavior rules to all sellers with market-based rate tariffs and authorizations.

### **Additional Tariff Revisions Proposed By Staff**

43. In addition to the tariff revisions discussed above, Staff, in the Western Markets Report, also proposed tariff revisions relating to a seller's use of trading platforms, based on Staff's review of Enron's trading platform, Enron Online. Staff found that Enron Online lacked transparency and was subject to manipulation by Enron.<sup>27</sup> Accordingly, Staff recommended that future trading platforms be designed to provide a sufficient level of transparency to enable users to understand the movements of the market. Staff also recommended that the Commission condition electric power market-based rate tariffs and authorizations to require that sellers who use trading platforms use only those trading platforms that employ a "credit change monitor," i.e., a monitor that could be used to evaluate unusual patterns in credit changes in the platform. Staff found that without these safeguards, the credit structure could be used to manipulate access to other traders and the perceived market price.

44. Staff also recommended conditioning electric power market-based rate tariffs and

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<sup>27</sup>See Western Markets Reports at ES-17.



authorizations to require that sellers who use trading platforms use only those trading platforms that agree to provide the Commission with full access to trade reporting and order book information for the trading systems and agree to adhere to appropriate monitoring requirements. To the extent the Commission promulgates standards for trading platforms, the Commission is considering conditioning electric power market-based rate sellers to use only those platforms that meet certain standards. The Commission seeks comment on this issue. We will not propose a market behavior rule relating to this recommendation at this time, however, pending our further review of this matter.

### **Legal Authority**

45. A number of commenters in this proceeding have challenged the Commission's legal authority under the FPA to condition sellers' market based rate tariffs and authorizations, as proposed in the November 20 Order. These commenters have asserted, among other things, that the potential financial consequences for sellers found to be in violation of their market-based rate tariffs, as revised, would violate the filed rate doctrine and the refund limitations set forth in Section 206(b) of FPA.<sup>28</sup>

46. For the reasons discussed below, we reject these challenges to the Commission's authority. We have 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. 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 propose, we will require that these tariffs be revised to include the rules prospectively, as Section 206 requires.<sup>29</sup> Thus, these tariff revisions, if approved, would not violate the filed rate

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<sup>28</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 5 months after the expiration of the such 60-day period.

<sup>29</sup>The Commission would intend to make the behavioral rules effective no earlier than the date of issuance of an order revising market-based rates tariffs to include new behavioral rules.

doctrine.<sup>30</sup>

47. Nor would the refund limitations of Section 206(b) of the FPA bar the Commission from enforcing the tariff revisions proposed herein. Rather, any remedies stemming from a violation of our proposed tariff provisions would be based on the tariff conditions themselves, as approved herein. It is well settled that the Commission may take actions and impose remedies when tariffs are violated. These actions, moreover, would be fully consistent with the oversight responsibilities implicit in our market-based rates program.

48. Sellers' authorizations, in this regard, rely upon the existence of competitive markets. As illustrated by the Western Markets Report, it is possible for actions to be taken by sellers that can affect whether the prices charged in such markets are at competitive levels. Conditioning market-based rate authority to require sellers to comply with market behavior rules will help ensure that sellers do not engage in anti-competitive behavior and that just and reasonable rates will be achieved. By imposing actionable behavioral rules conditioned upon the risk of material remedial action, the Commission can further the goal of competition while protecting consumers and other market participants who do not engage in anti-competitive behavior.

49. Thus, while we are undertaking a Section 206 investigation to determine whether market-based rate tariffs must be revised to include the proposed market behavior rules to be just and reasonable, the potential remedies resulting from violations of such rules will flow from our conditioning such tariffs to provide, as a component of the tariff, a clear right for the Commission to enforce its standards and for affected parties to be compensated for violations.<sup>31</sup> Such actions would be in the nature of a proceeding to

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<sup>30</sup>Commenters also assert that the filed rate doctrine would be violated in this case because the behavioral standard, as proposed in the November 20 Order, failed to provide adequate notice regarding the conduct it would prohibit. However, we will not address these allegations here, given the significant revisions to the market behavior rules we propose to adopt here. In fact, the "filed rate," in this case, would include a set of specific behavioral standards voluntarily accepted by the seller, the meaning and intent of which will be fully aired in this proceeding. In addition, the filed rate would make explicit that any violation of our market behavior rules would potentially result in financial consequences, as discussed herein. Under these circumstances, our market behavior rules would provide the necessary predictability required by the filed rate doctrine.

<sup>31</sup>We imposed a similar obligation, pursuant to our conditioning authority, in the  
(continued...)

determine whether there has been a tariff violation, not a complaint that rates, terms or conditions were unjust and unreasonable under Section 206.

50. The Commission has ample authority to condition market-based rate tariffs in this fashion.<sup>32</sup> Here, these conditions are both necessary and appropriate to ensure that rates charged by sellers in the wholesale market will be based on, and influenced by, competitive factors. We do not intend for these tariff provisions to supercede or replace in any way any party or the Commission's rights under Section 206 to file a complaint asserting that any rates, term or condition or service are unjust and unreasonable and requires revision as we are proposing with market-based tariffs herein.

51. Finally, we reject commenters' assertion that the initiation of a rulemaking proceeding would be required to implement the tariff provisions proposed in this proceeding. As we noted above, the Commission is making its proposed revisions to sellers' market-based rate authorizations in this proceeding, because these proposals would embody tariff revisions applicable to individual sellers, not rule changes. As we also noted, however, we are taking this action in the context of an investigation with comment procedures designed to implement full public input. The Commission, moreover, is not limited to notice and comment rulemaking in developing policy. Agencies generally are permitted considerable discretion to choose whether to proceed by rulemaking or by adjudication. Our decision to act in this proceeding pursuant to Section 206 is clearly within our authority.

### **Comment Procedures**

52. We will provide interested entities an opportunity to file comments and reply

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<sup>31</sup>(...continued)

California Refund Proceeding. 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. (9th Cir. June 29, 2001 and later).

<sup>32</sup>In fact, nothing in the Regulatory Fairness Act (RFA) (modifying FPA Section 206) or its legislative history suggests that Congress intended to address or limit the Commission's authority to condition market-based rate authorizations. Congress passed the RFA, which established the 15-month refund effective period, to give the Commission authority to order rate reductions for the period before the conclusion, but after the start, of Section 206 proceedings. See San Diego Gas and Electric Co. v. Sellers of Ancillary Services, et al., 97 FERC at 62,220.

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comments regarding the proposed market behavior rules set forth in the Attachment to this order. Initial comments will be due 30 days from the date this order is published in the Federal Register, and reply comments will be due 30 days from the date that initial comments are filed.

The Commission Orders:

(A) The tariff provision proposed by the Commission in the November 20 Order is hereby modified and revised, as set forth in the Attachment to this order, and as discussed herein;

(B) Interested entities may file comments and reply comments regarding the market behavior rules set forth in the Attachment to this order. Initial comments will be due 30 days from the date this order is published in the Federal Register, and reply comments will be due 30 days from the date that initial comments are filed;

(C) Requests for rehearing of the November 20 Order are hereby dismissed, as discussed in the body of this order;

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

By the Commission. Commissioner Massey concurring in part with a separate statement attached.

( S E A L ) Commissioner Brownell concurring with a separate statement attached.

Magalie R. Salas,  
Secretary.

### **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 rules and regulations of the applicable power market.
2. **Market Manipulation:** Actions or transactions without a legitimate business purpose which manipulate or attempt to manipulate market prices, market conditions, or market rules for electric energy and/or energy products, or result in market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand, are prohibited. Prohibited actions and transactions include, but are not limited to:
  - A. 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 (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; 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);
  - C. transactions in which an entity first creates artificial congestion and then "relieves" such artificial congestion;
  - D. collusion with another party for the purpose of creating market prices at levels differing from those set by market forces; and
  - E. 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.

3. **Communications:** Seller will 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, independent system operators, or similar entities.
4. **Reporting:** To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide complete, accurate and factual information to any such publisher. Seller shall notify the Commission of whether it engages in such reporting for all sales. In addition, the seller shall adhere to such other standards and requirements for price reporting as the Commission may order.
5. **Record Retention:** Seller will retain all data and information necessary for the reconstruction of the electric energy or electric energy products prices it charges or of the prices it reports for use in published price indices for a period of three years.
6. **Related Tariffs:** Seller shall not violate or collude with another party in actions that violate Seller's code of conduct or Order No. 889 standards of conduct.

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.



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 June 26, 2003)

MASSEY, Commissioner, concurring in part:

I wholeheartedly support conditions to all market-based tariffs that declare manipulation off limits. Such outrageous behavior has cast a pall over the promise of energy markets and has brought some companies to dire financial straits. These tariff conditions should deter bad behavior in the future. If they fail to do so, then at least the Commission will have industry wide legal tools to provide appropriate remedies. I commend Chairman Wood's strong leadership in developing this proposal.

I am writing separately to express my concern with one aspect of today's proposal. 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. 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 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 whole.<sup>33</sup> Unfortunately, today's order appears to take this remedy off of the table. I would prefer to tailor the remedy to the circumstances of each case. I encourage comments on this issue.

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

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<sup>33</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).



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William L. Massey  
Commissioner

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 June 26, 2003)

BROWNELL, Commissioner, concurring:

1. Today we issue an order proposing to place conditions on sellers of power that have been granted market based rate authority. This proposal, coming 18 months after the Commission first launched the idea of conditioning sellers' market-based rate authorities, builds on industry events of the last few years. I have spoken about the need for the "10 commandments" and am encouraged that we are taking this step. Importantly, the proposal attempts to balance three goals:

- effective remedies on behalf of customers in the event anti-competitive behavior or other market abuses occur;
- clearly delineated "rules of the road" to market-based rate sellers 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; and,
- 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.

2. I appreciate the need to balance these goals but have a fundamental concern that we've allowed markets to form without a full appreciation of what constitutes a market let alone the market dynamics that foster a truly competitive market. For example, what defines a competitive market and what constitutes scarcity pricing? These questions remain largely unanswered. I also fear that as the precise definition of manipulation develops over time, we will end up with overly proscriptive "rules of the road" that will dampen innovative, legitimate business tools. Finally, I am concerned about the applicability of behavioral rules to only one market segment - sellers. This troubles me - equitable rules should apply to all industry segments. I encourage and look forward to

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meaningful comments from all market segments. If we've learned nothing else, we've learned that rules are critical.

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Nora Mead Brownell  
Commissioner

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