

December 22, 2005

Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: *Investigation of Terms and Conditions of Public Utility Market-Based
Rate Authorizations*, Docket No. EL06-16-000
-and-
*Amendments to Codes of Conduct for Unbundled Sales Service and for
Persons Holding Blanket Marketing Certificates*, Docket No. RM06-5-000

Dear Secretary Salas:

Attached for e-filing in the two above-referenced proceedings are the
Comments of the National Association of State Utility Consumer Advocates (NASUCA).

Please file these comments in both dockets.

Sincerely,

Gerald A. Norlander, Esq.

Public Utility Law Project of New York, Inc.

90 State Street, Suite 601

Albany, NY 12207

On Behalf of:

National Association of State Utility

Consumer Advocates

8300 Colesville Road, Suite 101

Silver Spring, MD 20910

Attached: Comments of The National Association of State Utility Consumer Advocates on
Proposed Repeal of the Market Behavior Rules

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Docket No. EL06-16-000

Amendments to Codes of Conduct for Unbundled
Sales Service and for Persons Holding Blanket
Marketing Certificates

Docket No. RM06-5

COMMENTS OF THE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES
ON PROPOSED REPEAL OF THE MARKET BEHAVIOR RULES

I. Introduction

On November 21, 2005, the Commission issued an order in Docket No. EL06-16-000 “to
propose repeal of the Market Behavior Rules, which are currently included in all public utility

sellers' market-based rate tariffs and authorizations.”¹ The Commission invited comments on a set of specific questions relating to the proposed repeal of conditions now placed on market-based rates for jurisdictional sales of electricity and transmission service, encouraging “additional relevant comments regarding whether the Market Behavior Rules should be repealed.”² On the same day, in Docket No. RM06-5-000, the Commission issued a Notice of Proposed Rulemaking “seeking comments on whether to repeal sections 284.288 and 284.403 of its regulations . . . the central purpose of [which] is to prohibit market manipulation”³ of rates for natural gas service. The rules for natural gas service were adopted in Docket No. RM03-10-000 at the same time as the rules for electric service were adopted in Docket No. EL01-118-000.

The National Association of State Utility Consumer Advocates (“NASUCA”) is an association representing 44 state utility consumer advocate offices in 41 states and the District of Columbia. NASUCA member offices are authorized by the laws of their respective jurisdictions to represent the interests of utility consumers in matters before state and federal utility regulators and courts. NASUCA filed comments supportive of the Market Behavior Rules when they were initially proposed and in 2003 urged they be further strengthened and adopted to protect consumers.⁴

Because of the similarity of issues in Docket No. EL06-16-000 and Docket No. RM06-6-000, NASUCA respectfully submits these comments in both dockets in response to the

¹ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, Order Proposing Revisions to Market-Based Rate Tariffs and Authorizations, Docket No. EL-16-000 (Issued Nov. 21, 2005) (“*Order Proposing Repeal*”).

² *Order Proposing Repeal* at ¶ 26.

³ *Notice of Proposed Rulemaking, Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates*, Docket No. RM06-5-000.

⁴ NASUCA considered the adoption of Market Behavior Rules to be “an important step toward ensuring the competitiveness of electricity markets and the accuracy, liquidity and transparency of price indices.” *NASUCA Petition for Rehearing of Order Adopting Market Behavior Rules*, Docket No. EL01-118-000 Dec. 18, 2003.

Commission’s proposed repeal of the existing Market Behavior Rules applicable to jurisdictional electricity and natural gas service. NASUCA intends these comments to be applicable to both electricity and natural gas, unless otherwise indicated.

II. Comments

A. Overview

The Market Behavior Rules for electricity and natural gas service were adopted by the Commission in 2003, in the aftermath of numerous well known market rate abuses that had resulted in unreasonable rates and charges ultimately paid by retail consumers.⁵ The Commission now proposes repeal of the existing Market Behavior Rules.

The rationale for the proposed repeal is that Congress included new market manipulation prohibitions in the Energy Policy Act of 2005 (*EPAAct 2005*).⁶ The new statutory provisions prohibit the provision of false information to a federal agency relating to rates,⁷ and “any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers.”⁸ The Commission in a separate proceeding, Docket No. RM06-3-000 is proposing a new regulation to implement the new statutory prohibition:

⁵ “The Market Behavior Rules emanated from the Commission’s investigation of trading activity in Western markets during 2000-2001, which uncovered a number of trading schemes intended to take advantage of the then-existing electricity market in California.” *Prohibition of Energy Market Manipulation*, 113 FERC ¶ 61,067 (2005).

⁶ Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

⁷ “No entity . . . shall *willfully and knowingly* report any information relating to the price of electricity sold at wholesale or the availability of transmission capacity, which information the person or any other entity *knew to be false at the time of the reporting, to a Federal agency with intent to fraudulently affect the data being compiled by the Federal agency.*” *EPAAct 2005*, Sec. 211. (*Emphasis supplied*).

⁸ “(a) IN GENERAL.—It shall be unlawful for any entity . . . directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)), *in*

§ 47.1 Prohibition of Energy Market Manipulation.

(a) It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission,

(1) to use or employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person.

(b) Nothing in this § 47.1 shall be construed to create a private right of action.⁹

This proposed regulation is intended to track anti manipulation language of Securities and Exchange Commission (SEC) regulation 10b(5), judicial interpretations of which require a finding of intent before sanctions for any violation may be imposed. NASUCA in its comments on this proposed regulation stressed that the new statute and rule add to the Commission's existing powers and opposed a Commission indication it might repeal Market Behavior Rule 2.¹⁰

The proposed regulation would not require incorporation of an anti manipulation requirement into the utilities' filed market-based rate tariffs. Thus, a violation of the new rule,

contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers. EAct 2005, Sec. 222. (Emphasis supplied).

⁹ *Prohibition of Energy Market Manipulation*, Notice of Proposed Rulemaking, Docket No. RM06-3-000, (Issued October 20, 2005).

¹⁰ "NASUCA does not support the repeal of Market Behavior Rule 2. Any revisions to the Market Behavior Rules should be to expand the scope of the Rules to incorporate the Commission's new authority over market manipulation by all market entities To the extent that the Commission determines that any of the existing Market Behavior Rules should be reconsidered, NASUCA would urge the Commission to consider an expansion of those rules even further, to make the Rules applicable to all market participants." *NASUCA Comments* in Docket No. RM06-3-000, at 4-5, Nov. 17, 2005.

though potentially punishable by civil and criminal fines, would not appear to be a violation of the seller's own tariff. Put differently, if the Market Behavior Rules are repealed, there would no longer be an explicit obligation in the seller's tariff not to manipulate rates. As will be discussed later, this is a significant difference.

As justification for complete repeal of the existing tariff conditions in light of proposed Rule 47, the Commission indicated that some of the new statutory anti manipulation provisions may "overlap" or conflict with some of the existing Market Behavior Rules, *Order Proposing Repeal*, ¶ 14. The Commission noted that the new statute and rule will have an intent standard for sanctionable manipulation, while "[i]n contrast, Market Behavior Rule 2 does not require a showing of scienter, as it prohibits actions or transactions that 'foreseeably' could manipulate market prices, conditions, or rules." *Id.*, ¶ 15. Based on the perceived overlap, the Commission would completely abolish Market Behavior Rules 2 and 3, which contain the broader foreseeability standard, and rely instead on the intent standard, in order to eliminate "controversy and uncertainty."¹¹ NASUCA believes the existing "foreseeability" standard in the existing tariff conditions should be preserved to provide a remedy where unreasonable market-based rates are charged through negligent conduct of utilities, or other conduct falling short of being intentional but whose rate-altering impact is foreseeable. The Commission's current Market Behavior Rules incorporate both an intent standard and a foreseeability standard. Market Behavior Rule 2 prohibits "transactions that are without a legitimate business purpose and that are intended to *or foreseeably* could manipulate market prices, market conditions, or market rules..." (*Emphasis*

¹¹ "Market Behavior Rule 2 does not require a showing of scienter, as it prohibits actions or transactions that 'foreseeably' could manipulate market prices, conditions, or rules. The 'foreseeably' requirement has generated controversy and uncertainty, however. We believe the use of a scienter standard, given the precedent in other regulatory contexts, will draw a clearer line between acceptable and prohibited behavior." *Id.*

added). The Commission does not explain how a new rule prohibiting only intentional market manipulation provides greater protection than a rule creating consumer beneficial remedies for intentional acts as well as other acts that foreseeably manipulate markets.

Recognizing that some provisions of the existing Market Behavior Rules do not overlap at all with the new statutory language, the Commission nevertheless proposes that these too be repealed, because they are now deemed to be redundant. For example, Market Behavior Rule 1, requiring utilities to adhere to the rules of Regional Transmission Organization utilities (RTOs), a rule adopted in 2003 to assure reasonable rates, is now perceived to be superfluous, merely a restatement of existing obligations “enforceable through the organized market’s tariff and related agreements.” *Id.*, ¶ 20.¹² As is discussed below, consumer remedies of profit disgorgement available when a seller’s conduct violates its own FERC approved tariffs may not be available when the conduct violates the rules of another utility, the RTO. Inter-utility agreements may expressly provide that their breach does not give rise to enforcement by third party beneficiaries, including consumers.

For existing Market Behavior Rules that cannot be said to overlap with the proposed Rule 47, and which are not deemed duplicative of other rules, the Commission suggests they could be repealed and readopted as part of proposed Rule 47 or to other unspecified rules. For example, the *Order Proposing Repeal* indicates that the record retention requirement of Market Behavior Rule 5,¹³ a non-overlapping provision the Commission acknowledges is necessary and non-

¹² “For instance, Market Behavior Rule 1 is essentially a restatement of existing obligations to comply with Commission rules and regulations in organized markets. These are tariff requirements of the ISOs and RTOs, and failure of a market participant to follow these rules and regulations is enforceable through the organized market’s tariff and related agreements.” *Id.*

¹³ Market Rule 5 Provides: “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.”

redundant, could be incorporated in some other rule. By stripping the record keeping duty from the seller's tariff, however, remedies for the benefit of consumers when records are not kept may be limited.

Omitted from the Commission's discussion of the proposed repeal is any mention of a key provision of the existing Market Behavior Rules that is beneficial to consumers -- the unjust profit disgorgement remedy created in Market Behavior Rule 2. The *Order Proposing Repeal* is completely silent as to whether this important consumer remedy, previously found necessary, will survive repeal of the tariff conditions.

Simultaneously, the Commission is proposing to eliminate the profit disgorgement remedy for natural gas market manipulation. Today, any violation of the existing rules applicable to natural gas market manipulation "may subject Seller to disgorgement of unjust profits from the date when the violation occurred. Seller may also be subject to suspension or revocation of its blanket certificate . . . or other appropriate non-monetary remedies. 18 CFR §284.403(d). Under the proposed change in rules applicable to natural gas, this remedy is characterized as "largely procedural in nature"¹⁴ and, the Commission states, if it decides to repeal the existing behavior rules, the section creating the disgorgement remedy and other provisions "would become superfluous . . . and therefore should be deleted."¹⁵

B. EAct 2005 Did Not Supplant FERC's Existing Market Behavior Rules.

EAct 2005 did not supplant FERC's existing market behavior rules. Rather, the new statutory prohibition of manipulation supplements the existing rules. In its discussion of the interplay between proposed Rule 47 and the existing Market Behavior Rules required to be in

¹⁴ *NOPR, Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates*, Docket No. RM06-5-000., at ¶ 6 (Nov. 21, 2005).

¹⁵ *Id.*, at ¶ 18.

each seller's tariff, the *Order Proposing Repeal* does not fully address the language of the new statute. The new statute prohibits manipulation of rates "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers." *EPAAct 2005*, Sec. 222. This express recognition by Congress of the Commission's power to adopt rules "for the protection of electric ratepayers" is an encouragement of more detailed rules to protect consumers, not an invitation for the Commission to erase all the existing specific Market Behavior Rules and leave only a general, "catch-all" provision. This congressional expectation that the Commission will add more anti-manipulation measures, not subtract them, is not addressed in the *Order Proposing Repeal*.

Although Congress did indicate that the new statutory provision should be interpreted like Section 10(b) of the Securities Exchange Act, it cannot be claimed that erasure of all existing Commission rules, and substituting the general prohibition of Rule 47, is necessary to follow either the new statutory language or the SEC model it references. As noted by the Commission in the *Notice of Proposed Rulemaking* for proposed Rule 47, the SEC has not abandoned its substantive behavior rules, the SEC has not relied exclusively on the generic, catch-all prohibition of manipulation in its Rule 10b-5, and likewise, the CFTC also relies on both a general catch-all prohibition and targeted, specific prohibitions of certain egregious market behavior.¹⁶

¹⁶ "For example, section 10(b) and Rule 10b-5, the SEC's general anti-fraud provision * * * exists alongside other, more targeted provisions, including but not limited to: section 9(a)(2) prohibiting manipulative conduct on national securities exchanges (15 U.S.C. § 78i (2005)); section 14(e) prohibiting any person from making material misstatements or omissions and from engaging in fraudulent conduct in connection with any tender offer (15 U.S.C. § 78n(e) (2005)); and section 17(a) prohibiting fraud in connection with the sale of securities (15 U.S.C. § 77q(a) (2005)). Similarly, the CFTC's general anti-fraud provision in section 4b exists alongside other CFTC anti-manipulation provisions..." *Notice of Proposed Rulemaking, Prohibition of Energy Market Manipulation*, Docket No. RM06-3-000, October 20, 2005. (*Emphasis added*).

In addition, there are other reasons why the Commission should not place exclusive reliance on the SEC catch-all provision. The Commission has a statutory duty to ensure that all rates under its jurisdiction demanded and charged are just and reasonable. In contrast, the SEC has no comparable obligation to see that all stock market prices are just and reasonable. Also, Section 10(b) of the Securities Exchange Act of 1934 imposes private civil liability on parties who commit a manipulative or deceptive act in connection with the purchase or sale of securities.¹⁷ This enables private civil action plaintiffs to play a significant role in deterring manipulation of security prices and in achieving remedies for those injured by manipulation. In contrast, Congress expressly barred private civil actions to redress manipulation of electric rates under the Commission's jurisdiction.¹⁸ Consumers must depend upon FERC and the courts to enforce the just and reasonable rate requirements of the Federal Power Act because, once rates pass muster at FERC, they are almost inevitably passed through to retail ratepayers. Continuation of the tariff conditions provides an additional tool for FERC to remedy unreasonable and manipulated rates.

Chairman Kelliher has observed that “[i]t is clear that the Energy Policy Act of 2005 did not reverse or repeal Market Behavioral Rules, but it is also clear it did not ratify them.... It is

¹⁷ “As we have interpreted it, 10(b) of the Securities Exchange Act of 1934 imposes private civil liability on those who commit a manipulative or deceptive act in connection with the purchase or sale of securities.” *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994).

¹⁸ Although the new statute and subsection (b) of the Commission's proposed regulations bar any private right of action based on violation of the anti-manipulation regulation, the Commission noted that this “is not intended to take away any other right that may otherwise exist.” *Notice of Proposed Rulemaking, Prohibition of Energy Market Manipulation*, Docket No. RM06-3-000, October 20, 2005, ¶ 10, fn. 13. But if the existing tariff-based Market Behavior Rules are repealed by the Commission in the name of implementing the new statute, then an existing right remedy for the benefit of consumers – disgorgement of unjust profits to redress unreasonable rates -- obtained through violation of tariff conditions, may be taken away.

plain that we have discretion to reform or to repeal the Market Behavioral Rules.”¹⁹ There certainly is no evidence that Congress intended the Commission to relax its oversight or, as discussed below, relinquish its power to assure disgorgement of unjust profits gained in violation of tariff conditions.

NASUCA urges a more measured approach than wholesale repeal of the rules now engrafted into all market-based electricity rate tariffs and the similar rules applicable to natural gas sales. Such an approach would preserve the Commission’s assertion of broad power to remedy tariff violations for the benefit of consumers, and preserve the assertion of power to deter the range of actions that foreseeably result in unreasonable rates but which may fall short of the intentional manipulation proscribed by the new statute and proposed Rule 47.

C. The Existing Market Behavior Rules Should be Continued Because they Support a Disgorgement Remedy and Because the Existing Tariff Conditions Have Not Been Shown to be Unjust and Unreasonable.

Elimination of tariff conditions, even if new Commission rules are substituted, may strip the Commission of legal authority to provide a critical consumer remedy when the Market Behavior Rules are violated -- the disgorgement of unjust profits.²⁰ The Market Behavior Rules are implemented as standard tariff conditions, a critical component of which is the following acknowledgment now made by every utility filing an electric market-based rate tariff:

¹⁹ *Statement of Chairman Kelliher on proposed changes to the Market Behavioral Rules* (Docket Nos. RM06-5 and EL06-16).

http://www.ferc.gov/press_room/statements/kelliher/11_17_05_kelliher_rules.pdf

²⁰ When the rules were adopted, NASUCA supported measures stronger than simple disgorgement of profits from manipulation, stating “[d]isgorgement alone will not deter those intending to manipulate markets as there is no consequence for “going for gold” if all the bad actor has to do when manipulation is detected is disgorge the ill-gotten gains NASUCA urges the Commission to include a “make the market whole” remedy, as well as a monetary penalty.” *NASUCA Petition for Rehearing* in Docket No. EL01-118-000, Dec. 17, 2003. This concept was supported by Commissioner Massey in his concurring opinions to the orders adopting the Market Behavior Rules. The newly stiffened penalties for intentional manipulation may have narrow application because they require findings of knowing and willful violation of the statute, and they do not redress overcharges.

*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.*²¹

A legal foundation for profit disgorgement to remedy violations of the Market Behavior Rules is the Commission's theory that the rules are incorporated in the utility's own filed tariff, and so a disgorgement remedy for the benefit of consumers is not retroactive resetting of the filed rate.

“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.”²²

Under the Commission's tariff condition theory, disgorgement of unjust profits would not run afoul of filed rate doctrines because it would merely be requiring the utility to adhere to its previously filed market-based rate tariff. Some utilities are challenging the Market Behavior Rules in pending litigation, claiming that the disgorgement remedy is retroactive ratemaking in violation of FPA Section 206 and Section 7 of the Natural Gas Act.²³ The Commission should

²¹ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, “Order Amending Market-Based Rate Tariffs and Authorizations,” Appendix A, 105 FERC ¶ 61,218 (Nov. 17, 2003) (*Emphasis added*).

²² *Id.* (*Emphasis added*).

²³ The *Order Proposing Repeal* indicates at footnote 2 the pendency of judicial challenges to the Market Behavior Rules. Utility petitioners in that case state “[t]he distinction between the Commission's [tariff] conditioning authority and the statutory framework establishing its authority to impose retroactive refunds is at the crux of this case; that is, how far can the Commission extend its conditioning authority under [FPA] Section 205 and [NGA] Section 7 without unlawfully circumventing [FPA] Section 206 and

not capitulate to utility objections to the Market Behavior Rules by repealing these rules and the disgorgement remedy now in the electric utilities' tariffs and in the existing regulation applicable to natural gas price manipulation, 18 CFR § 284.403(d).

If the substance of any repealed Market Behavior Rule is reincorporated in a new or revised FERC regulation, the Commission's power to provide a profit disgorgement remedy may be eliminated, or rendered vulnerable to new challenges and prolonged uncertainty as to whether the rule and the disgorgement remedy are integral to the tariff. The Commission's *Order Proposing Repeal* does not mention the disgorgement of profits remedy that is now a part of all market-based rate tariffs for electricity,²⁴ and the NOPR for repeal of the rules now applicable to natural gas market rate sales considers the disgorgement rule to be procedural or superfluous. The Commission should not, in an effort "to provide greater clarity and regulatory certainty to the industry,"²⁵ eliminate profit disgorgement as a deterrent to manipulation and remedy for consumers. If it is not the intent of the Commission to abandon the disgorgement remedy, then it should continue to be engrafted onto every market-based rate tariff, with a continued acknowledgment by the utility in its tariff of the disgorgement remedy for the benefit of consumers, and the regulation authorizing the profit disgorgement remedy for natural gas rate manipulation, 18 CFR § 284.403(d), should also be retained.

The statutory predicate for the adoption of the Market Behavior Rules in 2003 was a formal Commission finding under FPA § 206 that without engrafting the Market Behavior Rules

[NGA] Section 5?" *Cinergy Marketing & Trading, L.P. v. FERC*, Nos. 04-1168 et al. (D.C. Cir., appeal filed April 28, 2004) *Initial Brief of Market Participant Petitioners* at p. 38 (April 29, 2005).

²⁴ The list of existing Market Behavior Rules attached to the *Order Proposing Repeal* recites the substance of Rules 1-6 but does not contain the statement at the end regarding the disgorgement remedy, which is contained in the original order establishing the Market Behavior Rule tariff conditions.

²⁵ *Notice of Proposed Rulemaking, Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates*, Docket No. RM06-5-000, at ¶ 11 (Nov. 21, 2005).

into all market-based rate tariffs, all market-based rates for electricity are unjust and unreasonable. The Commission stated then:

“[W]e 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.”²⁶

The *Order Proposing Repeal* asserts that it too is premised upon FPA § 206, and now proposes to eliminate entirely these tariff conditions containing “clearly-delineated rules of the road to govern market participant conduct.” *Id.*, ¶ 1. FERC lacks the power to revise utility tariffs without a formal finding under Section 206 that the tariff or rule now in force is unjust and unreasonable.²⁷ The

²⁶ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, “Order Amending Market-Based Rate Tariffs and Authorizations,” 105 FERC ¶ 61,218 (2003), reh’g denied, 107 FERC ¶ 61,175 (2004) (“*Market Behavior Rules Order*”) (*Emphasis added*).

²⁷ “(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues. Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, *or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential*, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section *shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force*, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and

prior finding of the Commission that all market-based rates for electricity are unreasonable without tariffs that include the Market Behavior Rules as tariff conditions cannot subsequently be overturned without a change of circumstances and a new finding that the existing tariff conditions have become unjust and unreasonable. There is no finding in this case, however, that the existing Market Behavior Rules now made a part of all market-based rate tariffs for electricity are unjust and unreasonable. Nor has there been a fundamental change of circumstances warranting repeal of the regulations applicable to manipulation of rates for natural gas. The *Order Proposing Repeal* invokes the Commission's general rulemaking authority under the Department of Energy Organization Act, but this does not give the Commission power to modify filed tariffs, which is constrained by Section 206, or to eliminate existing rules by invoking reorganization authority without actually identifying the details of the proposed changes. The statutory and factual predicates for abolition of the Market Behavior Rules adopted in 2003 are simply absent.

In addition, FPA Section 206 requires the Commission, when modifying rules affecting rates, to "state the change or changes to be made." *Id.* The *Order Proposing Repeal* acknowledges that certain portions of the existing rules may need to be modified or retained as parts of other rules. *The Order Proposing Repeal*, however, does not actually identify "the change or changes to be made" or show how the language of any other existing or proposed rules would be amended to preserve the force of any provisions the Commission may wish to

place of such hearing and shall specify the issues to be adjudicated. 16 U.S.C. § 824e (2000) (*Emphasis added*).

save after repeal.²⁸ Accordingly, the *Order Proposing Repeal* is deficient because it fails to identify the changes to be made.

D. Response to Specific Questions

As indicated above, NASUCA opposes repeal of the Market Behavior Rules, and recommends revision only of any specific portions found to be in conflict with statutory changes. The Commission requested public comment on a number of specific issues. NASUCA's response to those questions follows.

1. Are there any aspects of the Market Behavior Rules that should be retained in market-based rate sellers' tariffs and authorizations, or can all substantive provisions of the Market Behavior Rules be reflected in the proposed Part 47 regulations and other Commission rules and regulations?

In its orders adopting the current Market Behavior Rules, the Commission adopted an enforcement strategy of incorporating the rules into all market-based rate tariffs. By structuring the requirements in this fashion, utility violations could be redressed under the Commission's traditional powers to enforce existing tariffs. Prominent among the remedies for rule violations is the power to require disgorgement of unjust charges.²⁹ This remedy is significant, inasmuch as the Commission's market-based rate regime allows sellers with market-based rates to change

²⁸ "We propose repealing the Market Behavior Rules once we have issued final regulations implementing the antimanipulation provisions of EPCRA 2005 and have incorporated other aspects of the Market Behavior Rules in appropriate Commission orders, rules, and regulations." *Order Proposing Repeal*, ¶ 1. (*Emphasis added*). There is no clear identification of the "other aspects" of the Market Behavior Rules to be retained or the "appropriate" rules and regulations to be modified to accomplish this.

²⁹ The Ninth Circuit upheld the Commission's power to require refunds when it found that utilities had violated requirements inherent in their market based rates, i.e., the grant of authority to impose new charges without public filing of rate changes carried with it an obligation to file post-hoc rate reports, and when that requirement was violated, rates could be revised on a theory of enforcing current tariffs without running afoul of the Section 206 general proscription of retroactive rate revision. *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, *motion for rehearing pending* (9th Cir. 2004).

and implement new charges without prior public filing and without any *ex ante* review for reasonableness of the new charges.³⁰

The new statute increased the monetary penalties payable to the government for “willfully and knowingly” violating the FPA, and does not mention disgorgement of unjust profits or charges. The proposed new Part 47 rules for implementation of the new statutory changes also do not mention any disgorgement remedy for the benefit of consumers. The new statute is penal in nature, including the civil penalties, and so the new statutory provisions could be read very narrowly by the courts and may not provide support for a disgorgement remedy now based on the theory of tariff violation. As a result, eliminating the Rules as tariff conditions could diminish the Commission’s power to provide remedies now available for the benefit of consumers.

Market Rule 1 now requires utilities with market-based rates to adhere to the Commission-approved rules of RTOs and ISOs, as a tariff condition of the seller.³¹ This creates a direct obligation of the utility as a part of its tariff. The Commission suggests that Rule 1 - previously deemed necessary to remedy unjust and unreasonable market-based rate tariffs - is now merely surplusage:

“Market Behavior Rule 1 is essentially a restatement of existing obligations to comply with Commission rules and regulations in organized markets. These are tariff requirements of the ISOs and RTOs, and failure of a market participant to

³⁰ Some consumer advocates have challenged the Commission’s orders adopting market behavior rules as violative of FPA Section 205 because, *inter alia*, the rules still do not require adherence to statutory requirements for advance public filing of all rates and changes in rates and charges.

³¹ “**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.” *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, “Order Amending Market-Based Rate Tariffs and Authorizations,” 105 FERC ¶ 61,218 (2003), Appendix A.

follow these rules and regulations is enforceable through the organized market's tariff and related agreements."³²

When market Rule 1 was adopted, however, the Commission expressly found that reliance on derivative RTO/ISO enforcement of market rules via their tariffs, or reliance on private parties to enforce their contractual arrangements, is not always sufficient to ensure just and reasonable rates:

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.³³

On rehearing, the Commission further clarified that:

Market Behavior Rule 1 is intended to serve the purpose of reinforcing a seller's compliance obligation to adhere to Commission-approved rules and provides a remedy, with specified complaint procedures in those cases where a seller has failed to follow a Commission-approved rule or regulation.³⁴

This backstop direct tariff enforcement remedy "reinforcing" the RTO/ISO tariffs was found by the Commission to be an essential bulwark against unjust and unreasonable rates and charges, and nothing in the new statutory provisions changes that. There is no basis for FERC now to eliminate this recognized tariff enforcement remedy, and to substitute utility or private

³² *Order Proposing Repeal*, para. 20.

³³ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, "Order Amending Market-Based Rate Tariffs and Authorizations," 105 FERC ¶ 61,218 (2003), para. 19 (Emphasis added)..

³⁴ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, Order Denying Rehearing, 107 FERC ¶ 61,175 (2004), para. 22. (Emphasis added).

enforcement which may lack the power the Commission possesses to craft a remedy for the benefit of consumers. Private agreements among the utilities do not assure protection or remedies for the benefit of consumers who are not parties to those agreements. It is the obligation of the Commission - not utilities - to enforce its rules against utility rate manipulation and to effectuate the “Federal Power Act's primary purpose of protecting the utility's customers.”³⁵

³⁵ *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985).

2. Is there a need or basis for retaining existing Market Behavior Rule 2 in light of the anti-manipulation provisions set forth in the proposed Part 47 regulations?

The Commission should retain Market Behavior Rule 2 because it covers a broader range of activities that could manipulate rates than the new rules. Rule 2 provides:

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.

In contrast, the newly proposed rules will bar only intentional acts that manipulate rates. As discussed previously, the Commission adopted Rule 2 in order to provide clear "rules of the road" as to some activities clearly prohibited. There is no reason to scuttle these and rely exclusively on a general prohibition of intentional rate manipulation.

3. ***Should the Commission incorporate the qualification that no action or transaction explicitly contemplated by Commission rules, or undertaken at the direction of an ISO***

or RTO, is a violation of Market Behavior Rule 2 into the proposed Part 47 regulations?

This provision creates a “safe harbor” for actions “contemplated by Commission rules” or taken at the direction of an ISO. If all the specific rules protecting consumers are to be repealed, it is unjustified to preserve only the portions benefitting utilities.

4. *Should the affirmative defense of “legitimate business purpose” in existing Market Behavior Rule 2 be retained in any form?*

NASUCA in its prior comments was critical of this language when the rule was adopted, because it may allow justification of actions short of intentional manipulation that result in manipulated, unreasonable rates. There is no reason to save the provision to protect utilities if the Market Behavior Rules are repealed, and all that is left is a regulatory prohibition of intentional rate manipulation, which presumably is not a legitimate business purpose.

5. *Is there any aspect of behavior forbidden by Market Behavior Rule 3 that would not act as a fraud or deceit in connection with the purchase or sale of electric energy or transmission services subject to the Commission’s jurisdiction?*

Market Rule 3 encompasses behavior that would not qualify as intentional fraud or deceit under the newly proposed rules:

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.

Market Behavior Rule 3 should be retained because it covers and provides a remedy for a broader range of misinformation than the new statute and the regulations proposed to implement

it. The new statute creates increased monetary penalties, payable to the government, but the new penalties will apply only to persons who “willingly and knowingly” utilize intentional fraud to manipulate rates. Market Behavior Rule 3 covers a broader range of rate manipulating that may not rise to the level of intentional misrepresentation. As stated by the Commission:

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.³⁶

This rule, for example, would encompass negligent reporting conduct that foreseeably will manipulate rates.³⁷ The Commission found that without this rule, all market-based rates are unjust and unreasonable, and that this rule is necessary to ensure just and reasonable rates. There is no basis for assuming that a new statute and regulation aimed at a narrower subset of intentional activities negates the need to protect consumers from the broader range of rate manipulation activities covered by Rule 3.

6. Is the requirement of Market Behavior Rule 4 to report transaction information accurately, to the extent a seller reports such information to price index publishers, necessary in light of the proposed Part 47 regulations?

The existing market behavior rule 4, which addresses manipulation of rates reported by private publishers should be retained. It provides as follows:

³⁶ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, “Order Amending Market-Based Rate Tariffs and Authorizations,” 105 FERC ¶ 61,218 (2003), para 110.

³⁷ Acts or omissions that foreseeably could result in distortion of rates may not be subject to the new prohibitions if there is a lack of willful and knowing intent on the part of the utility. In an incident last year, a mistaken natural gas storage report to EIA may have raised rates by more than \$1 billion. Ian Urbina, *A Bookkeeping Error Adds To Heating Bills Statewide*, N.Y. Times, February 20, 2005, p. 38, col. 1. Rule 3 and the foreseeability standard may work to deter negligent or other unintentional conduct that has the effect of manipulating rates.

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.

As indicated previously, the price manipulation standard under the new statute and proposed Rule 47 requires proof of actions intended to manipulate rates before statutory penalties payable to the government are invoked, which further require proof that the actions were undertaken knowingly and willfully in violation of law. Under existing rules, negligent or other conduct that foreseeably results in misreporting of data, rate manipulation, and unreasonable rates, but which falls short of the more deliberate violations punishable by civil and criminal fines payable to the government, would warrant Commission action and possible disgorgement of unjust profits for the protection of consumers. If the rules are repealed, however, these remedies will no longer be available.

7. *Is there any aspect of Market Behavior Rule 6 that is not covered directly and explicitly by each seller's code of conduct as contained in tariff authorizations, or by the Standards of Conduct in Part 358 of our regulations, or by the proposed Part 47 regulations?*

Market Rule 6 provides:

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.

As previously discussed, the existing tariffs include a specific disgorgement remedy for violation of Rule 6. Repeal of the rules, as is now proposed, also repeals the disgorgement remedy based on a violation of Rule 6. This requirement and remedy for the benefit of consumers, previously found to be necessary to make market-based rates just and reasonable, should not be abandoned.

CONCLUSION

NASUCA urges a more measured approach than wholesale repeal of the rules now applicable to all electricity and natural gas service sold at market-based rates. Such an approach would preserve the Commission's assertion of broad power to remedy violations for the benefit of consumers, and would preserve the assertion of power to deter the range of actions that foreseeably result in unreasonable rates but which may fall short of the intentional manipulation proscribed by the new statute and proposed Rule 47. The new statutory prohibitions and civil and criminal penalties are payable to the government for manipulation of rates, and so the proposed Commission regulation for enforcing the new statutory measures did not render unnecessary the Commission's existing Market Behavior Rules and remedies for manipulation, including profit disgorgement.

The Commission should not undertake a blanket repeal of the existing Market Behavior Rules, and should modify them only upon a finding that a specific provision clashes with the new statutory provisions or a finding, made on a record, that tariff conditions and rules found necessary in 2003 to assure market-based rates are reasonable have now become unjust and unreasonable.

Alternatively, if the Commission repeals the Market Behavior Rules, it should take action to preserve the remedy of disgorgement of unjust profits from rate manipulation. The Commission should, at a minimum, preserve its claim of authority to require disgorgement of unjust profits for the benefit of consumers whenever rate manipulation occurs.

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Respectfully submitted,

Gerald A. Norlander, Esq.
Public Utility Law Project of New York, Inc.
90 State Street, Suite 601
Albany, NY 12207
(518) 449-3375

On Behalf of:
National Association of State Utility
Consumer Advocates
8300 Colesville Road, Suite 101
Silver Spring, MD 20910
(301) 589-6313