

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 Manipulation in Western Markets (Western Markets Report).³ 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; (4) reporting; (5) record retention; and (6) related tariffs.⁴ 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.⁵

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.

⁴ 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.

⁵ 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**.

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.

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.⁶ 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 ongoing investigation of that market in the California Refund Proceeding.⁷

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

⁶ 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.

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

³ 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 Web site.