

system operator if they are unable to follow the dispatch instructions they receive. The New York ISO also proposes that Market Behavior Rule 1 be modified to require sellers to use their "best efforts to comply with the operating instructions of the applicable power system operator."

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

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

17. Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrill Lynch, *et al.*) request clarification that Market Behavior Rule 1 will not apply to marketers that do not own generation. Merrill Lynch, *et al.* also argue that scheduling services

should not, by itself, be considered sufficient to constitute "control" of generation. Finally, the Colorado Office of Consumer Counsel¹⁵ (Colorado Consumer Counsel, *et al.*) interprets Market Behavior Rule 1 as a prohibition against capacity withholding and seeks clarification regarding the application of such a rule to hydroelectric generation in those parts of the country where hydro power is used primarily for peak shaving.

3. Commission Ruling

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

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

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

20. Commenters assert and we agree, however, that the rules and regulations to which this rule refers should be limited to "Commission-approved" rules and regulations of the applicable power market. We agree that it would not be appropriate to require that a market-based rate seller be made subject to potential sanction for rules or regulations (e.g., technical guidelines set forth in protocols) that have not been filed with the Commission. We also

clarify that Market Behavior Rule 1, while requiring compliance with any Commission-approved rule or regulation of the applicable power market, will not otherwise apply to any bilateral power sales arrangement or other transactions to which the seller may be a party.

21. We will also revise Market Behavior Rule 1 to make clear that no "must offer" requirement will be imposed under this rule. As revised, the rule makes clear that "[c]ompliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller." Unless the seller is subject to a must-offer requirement pursuant to the applicability of a Commission-approved tariff, or other specific Commission-approved obligation, then, the seller will not be subject to such a requirement under our rule.¹⁶ We also clarify that our rule is not intended to supersede market-specific rules such as those for outage scheduling/reporting and bidding that we have approved in our acceptance of ISO/RTO tariffs. In sum, we clarify that this rule is not intended to serve as an independent basis to impose any new obligations on sellers, or to further regulate bilateral markets.¹⁷

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

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

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

¹⁴ See e.g., Comments of Exelon at 5; Reply Comments of Central Maine, *et al.* at 3.

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

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

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