

lack of elasticity of demand in an organized market) may explain a given dysfunction in the interplay between supply and demand. To avoid confusion on this point, then, and because our objectives with respect to this rule can be satisfied under the surviving clause, discussed above, we have eliminated this term from our rule. We clarify, then, that our rule is not meant to say that we will identify prices that properly reflect supply and demand and then take action against sellers whose prices (however they may be established) differ. Rather, our rule is designed to prohibit market-based rate sellers from taking actions without a legitimate business purpose which intend to or foreseeably could interfere with the prices that would be set by competitive forces.²⁷

41. We will reject commenters' argument that Market Behavior Rule 2 should identify and prohibit only expressly-defined acts of manipulation. For all the reasons discussed above, it is essential and appropriate that we have a prohibition designed to prohibit all forms of manipulative conduct. In approving such a prohibition, moreover, we take the necessary safeguards, both procedural and substantive. Thus, in the event the Commission receives a complaint about a particular behavior or identifies such behavior on its own, we will inquire into all of the surrounding facts and circumstances to understand the purpose for which the behavior was undertaken and the intended or foreseeable outcome of the behavior.

42. As a threshold matter, the Commission will evaluate if the facts presented appear to warrant further inquiry into whether the transaction appears to be of a questionable purpose. For example, actions or transactions undertaken at the direction of an ISO or an RTO are not, by definition, market manipulation in violation of our rule. In determining whether an activity is in violation of our rule, we will evaluate whether the activity was designed to lead to (or could foreseeably lead to) a distorted price not reflective of a competitive market.²⁸ If, thereafter, the market-based rate seller can establish that the behavior at issue was undertaken to provide service to a buyer with rates, terms, and conditions disciplined by the competitive forces of

the market, we would find the transaction to have a legitimate business purpose and its rates to reflect a just and reasonable competitive level.

43. Our approach to the enforcement of our rules, then, will be based on a consideration of the facts and circumstances of the conduct at issue to determine its purpose and intended or foreseeable result. We recognize that manipulation of energy markets does not happen by accident. However, we also recognize that intent often must be inferred from the facts and circumstances presented. Therefore, a violation of Market Behavior Rule 2 must involve conduct which is intended to, or could foreseeably result in, distorted prices.

44. While we believe that this approach to identifying and remedying market manipulation is necessary, we also believe it is fair. We believe, for example, that sellers can recognize the difference between actions and strategies that are in furtherance of legitimate profit opportunities, or which serve important market functions, and those that result in prices that would not have been bid or paid in the absence of manipulation. We expect our enforcement and complaint procedures, as approved herein, will allow us to timely examine and fairly determine, on a case-by-case basis, when, and if, a strategy employed by a seller lacks a legitimate business purpose.

45. Moreover, while our rules will apply to all jurisdictional markets, we note these rules will 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" tests as required by the contract). Rather, any party seeking contract reformation or abrogation based on a violation of one or more of the Market Behavior Rules adopted herein 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.

C. Market Behavior Rule 2(a) (Prohibition Against Wash Trades)

1. Commission Proposal

46. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we

also proposed to prohibit wash trades as a specific transaction that would be prohibited under our proposed rule, *i.e.*, "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."

2. Comments

47. The New York ISO suggests that as an alternative to this express prohibition, the Commission should rely on the ISO (or RTO) market monitoring unit to craft and implement rules specifically tailored to address improper conduct if and as it arises.²⁹ The New York ISO also states that even if this express prohibition is adopted, the relevant aspects of the proposed rule should be incorporated into the reporting requirement embodied in Market Behavior Rule 4 (discussed below).

48. NASUCA asserts that the proposed definition of "wash trade" is too narrow, allowing sellers to evade regulation by slightly altering their transactions as they relate to price or quantity. The California Electricity Oversight Board (Cal Oversight Board) agrees, noting that by contrast, the Commodity Exchange Act defines wash trades as transactions producing "a *virtual* financial nullity because the resulting net financial position is *near or equal to zero*."³⁰ The Cal Oversight Board further asserts that if the Commission's wash trade prohibition is limited to the "same parties," as proposed, the Commission would be unable to sanction transactions entered into between independent or affiliated third parties.

49. Northeast Utilities argues that the proposed rule is too broad, prohibiting sellers from engaging in legitimate "sleeve" transactions and other legitimate transactions. EEI also asserts that the proposed rule could be applied to legitimate transactions in an unfair and unjustified way. EEI states, for example, that market participants sometimes engage in product swaps between different locations to avoid the need to use physical transmission and that these transactions are both useful and legitimate.³¹ To exempt such transactions from the prohibitions contemplated by Market Behavior Rule 2(a), therefore, EEI suggests that the qualifying language "at the same location" be added after the phrase

²⁷ The rule, then, covers actions that are intended to manipulate prices regardless of whether these actions actually accomplish their purpose. We note, however, that in most such cases, there will be no unjust profits to disgorge.

²⁸ When deciding how best to allocate our enforcement resources, we intend to focus our efforts primarily on those actions or transactions that have, in fact, caused distorted market prices.

²⁹ As discussed below, the New York ISO makes the same suggestion as it relates to Market Behavior Rules 2(b) and 2(c).

³⁰ Comments of the Cal Oversight Board at 10–11, citing 7 U.S.C. 6c (2000) (emphasis added).

³¹ See also Comments of Dynegy at 8.