

37. Nonetheless, we are committed to making our rules as specific as possible and thus, we are adopting a number of the revisions proposed by commenters in order to clarify the scope and application of our rules.

38. We clarify that we are focusing on behavior undertaken without an appropriate commercial underpinning for the purpose of distorting prices from those that would otherwise occur in the competitive market. However, the proposed term that would have characterized as manipulative behavior an act resulting in "market prices which do not reflect the legitimate forces of supply and demand" has resulted in confusion. While we do not believe that our use of this term was inappropriate or unjustified (as we intended it), many commenters appear to have misunderstood its purpose, suggesting that causes other than manipulation 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 that this 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 that are intended to or foreseeably could interfere with the prices that would be set by competitive forces.<sup>22</sup> One such action would be a wash trade. As discussed below, wash trades have no economic risk or substance, and create a false price for use in indices or in the market in general.

39. Commenters have also raised questions regarding how the Commission will determine whether this rule has been violated. In determining whether an activity is in violation of our rule, we will examine all relevant facts and circumstances surrounding the activity to evaluate whether there is a legitimate business purpose attributable to the behavior. We will evaluate whether the activity was designed to lead to (or could foreseeably lead to) a distorted price that is not reflective of a competitive market. Our approach will be to consider the facts and circumstances of the activity to determine its purpose and its intended

or foreseeable result. However, the Commission recognizes that manipulation of energy markets does not happen by accident. We also recognize that intent often must be inferred from the facts and circumstances presented. Therefore, a violation of the instant rule must involve conduct which is intended to, or would foreseeably distort prices.<sup>23</sup>

40. Some ambiguity necessarily arises from the fact that we cannot expressly identify all behaviors that are precluded by the instant rule. However, in the Commission's view, the rule and its implementation provide sufficient clarity for market-based rates sellers to understand the scope of precluded behaviors. The rule clearly prohibits behaviors that are undertaken without a legitimate business purpose which are designed to, or foreseeably would, distort prices for jurisdictional natural gas sales.

41. Many commenters have raised concerns with the Commission's inclusion of the phrase "legitimate business purpose." The Commission's inclusion of the phrase is to assure sellers that transactions with economic substance in which a seller offers or provides service to a willing buyer where value is exchanged for value will not be considered prohibited by our rule. While several commenting sellers have raised concerns regarding the inclusion of the phrase "legitimate business purpose" in the rule, we believe that not only is the inclusion of the phrase necessary, it acts to ensure that such sellers acting in a pro-competitive manner will be able to show that their actions were not designed to distort prices or otherwise manipulate the market. Behaviors and transactions with economic substance in which a seller offers or provides service to a willing buyer where value is exchanged for value will be recognized as reflecting a legitimate business purpose consistent with just and reasonable rates. However, an action or transaction which is anticompetitive (even though it may be undertaken to maximize seller's profits), could not have a legitimate business purpose attributed to it under our rule.<sup>24</sup>

42. Prices for transactions undertaken in the competitive marketplace where value is exchanged for value should be

disciplined by market forces. On the other hand, all gas transactions may not be constrained by market forces. For example, if a gas merchant bought natural gas at a location typically used as an index reference point in a manner that drives prices higher (and promptly thereafter sold such gas at the market prevailing price at a loss) while also possessing a derivative position at a notional quantity significantly in excess of its physical gas position, that benefits from the increase in the market price of natural gas at this index reference point, these physical purchases may be interpreted as a component of a broader manipulative scheme and the cash market transactions may be found to be without a legitimate business purpose.<sup>25</sup>

43. We recognize that we are establishing a general rule that will become more clear and concrete after we have had the opportunity to consider actual cases. As with all new requirements of this nature, with caselaw comes further clarity. This reflects the fact that we oversee a dynamic and evolving market where addressing yesterday's concerns may not address tomorrow's. Nevertheless, experience in applying this rule should be instructive to both the Commission and market-based rates sellers. As we apply the rule, we will be mindful of the fact that we are not only taking steps to assure just and reasonable rates for a specific transaction but also providing guidance to sellers in general. As such, in determining the appropriate remedy for violations of this rule, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior.

44. The Commission rejects arguments that it 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 sum, we believe our rules, as modified, explained and adopted herein, put sellers and all market participants on fair notice regarding the conduct we seek to encourage and the conduct we seek to prohibit. Stripped to their essentials, these guidelines amount to the following: (i) Act consistently

<sup>23</sup> 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.

<sup>24</sup> See *Enron Power Marketing, Inc.*, 103 FERC ¶ 61,343 (2003) (revoking Enron's blanket marketing certificate authorization based on Enron's participation in wash trades having "no legitimate business purpose").

<sup>25</sup> Although the instant example focused upon gas market prices manipulated upward in order to benefit the merchant derivative position, the transactions implementing any manipulation of the natural gas market will not be considered legitimate. For further discussion of several manipulative strategies see the Commission Staff's Final Report on Price Manipulation in Western Markets, Chapter IX, p. IX-9 through IX-24.

<sup>22</sup> Our rules are designed to cover actions that are intended to manipulate prices regardless of whether such actions actually resulted in distorted prices. We note, however, that in most such cases there will be no unjust profits to disgorge.