



December 29, 2005

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

Re: Order Proposing Revisions To Market-Based Rate Authorizations;  
Docket No. EL06-16-000.

Dear Secretary Salas:

Enclosed for electronic filing are the New York Independent System Operator, Inc.'s ("NYISO's") Motion to Intervene and Comments in the above-captioned docket. Please contact the undersigned if you have questions regarding the NYISO's filing.

Sincerely,

/s/ Alex M. Schnell

Alex M. Schnell  
New York Independent System Operator, Inc.  
Ofc: 518-356-8707

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations</b>	) ) ) ) )	<b>Docket No. EL06-16-000</b>
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**MOTION TO INTERVENE AND COMMENTS OF THE  
NEW YORK INDEPENDENT SYSTEM OPERATOR**

Pursuant to sections 211 and 214 of the Commission’s Rules of Practice and Procedure,<sup>1</sup> the New York Independent System Operator, Inc. (“NYISO”) requests permission to intervene in the above-captioned docket and offers these comments in response to the Federal Energy Regulatory Commission’s (“Commission’s”) November 21, 2005 Order Proposing Revisions to Market-Based Rate Tariffs and Authorizations (“Order”).<sup>2</sup> In its Order the Commission proposes the prospective repeal of its Market Behavior Rules once the Commission has issued final regulations implementing the anti-manipulation provisions of the Electricity Modernization Act of 2005 (“EMA 2005”) and has incorporated other aspects of the Market Behavior Rules in appropriate orders, rules and regulations.

The purpose of the NYISO’s comments is to ensure that certain protections provided under the Market Behavior Rules that arguably might not be covered by the Commission’s proposed regulations implementing the EMA 2005<sup>3</sup> will be continued, by retaining the existing Market Behavior Rules and by incorporating these important and desirable aspects of the Market Behavior Rules in appropriate orders, rules and regulations, including new 18 C.F.R. Part 47

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<sup>1</sup> 18 C.F.R. §§ 385.211, 385.214 (2004).

<sup>2</sup> 113 FERC ¶ 61,190 (2005).

<sup>3</sup> See Prohibition of Energy Market Manipulation, 70 Fed. Reg. 61930 (proposed Oct. 20, 2005) (to be codified at 18 C.F.R. pts. 47 and 159).

(“Part 47”). For the reasons explained below, the Commission should not remove the Market Behavior Rules from the market-based rate tariffs of jurisdictional entities. At the very least, the Market Behavior Rules should remain in place until the substantive and remedial scope of the Commission’s authority under new § 222 of the Federal Power Act (“FPA”) has been subject to testing in the courts, and clearly established as co-extensive with the Commission’s authority under the Market Behavior Rules.

## **I. STATEMENT OF ISSUES**

This filing submits that the Commission should, for the reasons set forth in part III of this filing:

- Permit the NYISO to intervene, to protect its unique stake in the matters at issue;
- Not rescind the Market Behavior Rules, in order to provide necessary and appropriate protections for jurisdictional markets and purchasers in those markets; and
- Amend proposed 18 C.F.R. Part 47 to make clear the intended substantive scope and remedial reach of the Commission’s authority to police conduct that manipulates jurisdictional markets.

As authority for the above actions, the NYISO relies on the points and authorities discussed below, including:

- The unique interests of the NYISO in the matters at stake, which cannot be represented by any other entity.
- The actually or potentially broader substantive scope of the Market Behavior Rules as compared to Part 47, and the Commission’s continuing obligation under FPA § 205 to ensure that jurisdictional rates are just and reasonable, not

withstanding its new authority under FPA § 222 to take action against market manipulation.

- The broad authority granted to the Commission under FPA § 222 to issue regulations implementing the Commission’s authority to take action against market manipulation, including the imposition of a range of appropriate remedies.
- The uncertainty of the substantive and remedial scope of FPA § 222 and Part 47, and the absence of any statutory or policy justification for not maintaining available protections under FPA §§ 205 and 206 unless and until it has been established that FPA § 222 and Part 47 provide equivalent protection to the Market Behavior Rules.
- SEC precedent for disgorgement and other equitable remedies against fraud, deceit and market manipulation.

## **II. MOTION TO INTERVENE**

The NYISO is the independent body responsible for providing open-access transmission service, maintaining reliability, and administering competitive wholesale electricity markets in New York State. The NYISO’s duties include monitoring the markets it administers for manipulation of its market rules or violations of the Commission’s Market Behavior Rules and informing the Commission’s Office of Market Oversight and Investigation (“OMOI”) if it identifies possible market manipulation or other inappropriate activity occurring in the markets it administers.

The Commission’s proposal to repeal its Market Behavior Rules raises concerns that are directly relevant to the fair and accurate operation of the markets that the NYISO administers.

Commission action in this docket could have a significant impact on how both the NYISO and the Commission may permissibly respond to market participants that attempt to manipulate the markets administered by the NYISO, that fail to follow the market rules that the NYISO is responsible for administering, or that provide false or misleading information to the NYISO. The NYISO therefore has a direct and substantial interest in this proceeding. The NYISO's interest cannot be adequately represented by any other party, and the NYISO should therefore be permitted to intervene herein.

### **III. COMMENTS ADDRESSING THE PROPOSED ELIMINATION OF THE MARKET BEHAVIOR RULES**

#### **A. Introduction**

The NYISO supports the Commission's goal of continuing the obligations contained in its Market Behavior Rules while extending the jurisdictional reach of the Commission's enforcement authority over market manipulation beyond entities that have market-based rate tariffs on file with the Commission. In implementing its new regulations, the Commission must ensure that the alternate rules, regulations and orders it puts in place (1) adequately cover the types of manipulative or otherwise inappropriate conduct that can occur in ISO/RTO markets, (2) create an enforceable obligation for entities participating in ISO/RTO markets to comply with all applicable market rules, (3) place entities participating in ISO/RTO markets under an affirmative, readily enforceable obligation to provide accurate information to ISOs and RTOs (including an obligation not to submit misleading information by omission), and (4) do not have gaps in enforcement coverage.

Guided by these objectives, the NYISO is concerned that the Commission's proposal to repeal the Market Behavior Rules, which are based on Federal Power Act §§ 205 and 206, and

replace them with untested provisions under new FPA § 222, is premature. Until the Commission, market participants and market administrators such as the NYISO, and as may be necessary the U.S. Courts of Appeals, gain experience with §§ 222 and Part 47, it will not be clear that gaps in enforcement coverage will not occur, that Part 47 creates fully enforceable obligations for entities participating in ISO/RTO markets to comply with all applicable market rules, or that the obligation to provide true and correct information to ISOs and RTOs will be readily enforceable without undue cost and expense. These concerns will be substantially alleviated if the Commission does not repeal its Market Behavior Rules before its authority under new § 222 has been fully established, and only then if it is clear that the substantive and remedial protections under §222 and Part 47 are co-extensive with the Market Behavior Rules. To achieve this latter goal, the Commission should include additional protections in proposed Part 47.

The NYISO accordingly recommends that the Commission continue to require the incorporation of the Market Behavior Rules into market-based rate tariffs, and modify Part 47 as requested in these comments, to avoid enforcement gaps and to make clear that Part 47 encompasses the substantive conduct standards and the remedies now encompassed by the Market Behavior Rules.

To avoid any gaps in market protections, the NYISO also urges retention of the Market Behavior Rules until the Commission's proposed rules and regulations on market transparency and record retention, as described in the Order, are fully in place.<sup>4</sup>

**B. List of Issues**

**1. The Commission Should Not Unnecessarily Limit its Remedies for Market Manipulation.**

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<sup>4</sup> Order P 21 and 22.

The critical reason for the Commission's adoption of the Market Behavior Rules was to establish the Commission's authority under FPA § 205 to impose remedies, including disgorgement of undue profits or other economic benefits, for violation of the standards set forth in the Market Behavior Rules from the date that a violation occurred.<sup>5</sup> New Part 47 under new FPA § 222 seeks to implement new Commission authority under a new statutory provision, assertedly reaching the same conduct. Until the remedial scope of that new authority has been exercised and been subject to testing in the courts, and shown to be co-extensive with the Market Behavior Rules, there is no good reason to discard the protections provided by the Market Behavior Rules under the Commission's § 205 authority. To help ensure this co-extensive result, the Commission should make clear that it retains its ability to order disgorgement of unjust profits or other economic benefits attributable to a specific violation of new Part 47 from the date that a market manipulation first occurred.

The Market Behavior Rules were adopted as a condition of market-based rate tariffs primarily because the Commission recognized that its refund authority under Section 206 of the FPA (commencing 60 days after the filing of a complaint) was not adequate to permit it to police the operation of competitive markets.<sup>6</sup> By adding the Market Behavior Rules to jurisdictional sellers' market-based rate tariffs, the Commission gained "the authority to address promptly potential instances of anticompetitive behavior or exercises of market power through the

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<sup>5</sup> See *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 97 FERC ¶ 61,220 (2001); Order Seeking Comments on Proposed Revisions, 103 FERC ¶ 61,349 (2003); Order Amending Market-Based Rate Tariffs and Authorizations, 105 FERC ¶ 61,218 (2003); Order on Rehearing, 107 FERC ¶ 61,175 (2004).

<sup>6</sup> See *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 97 FERC ¶ 61,220, at 61,976; 103 FERC ¶ 61,349, at 62,379-80; 105 FERC ¶ 61,218, at 62,164-69; *on reh'g*, 107 FERC ¶ 61,175, at 61,724-26.

imposition of refunds or such other remedies as may be appropriate”<sup>7</sup> under Section 205 of the FPA, which has been interpreted to permit refunds commencing on the date that the violation of a rate, term or condition of a tariff that is on file with the Commission occurred.<sup>8</sup> While EMA 2005 has reduced the delay that applies to the Commission’s authority to issue refunds under Section 206 of the FPA from 60 days after the date a complaint is filed to the date that the complaint is filed, the EMA 2005 amendment to Section 206 still does not permit the Commission to order refunds from the date that a violation first occurred. This temporal gap in refund authority justified the Commission’s decision to condition its acceptance of market-based rate tariffs on the inclusion of the Market Behavior Rules in 2003 and it continues to justify the incorporation of the Market Behavior Rules in jurisdictional sellers’ market-based rate tariffs today.

In implementing its new authority under § 222, the Commission should use the authority conferred by that section to make clear that the new rules do not reopen any temporal or other gaps in the Commission’s remedial authority filled by the Market Behavior Rules. New FPA § 222 prohibits market manipulation “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.”<sup>9</sup> Against the background of the Market Behavior Rules, the recognized abuses that prompted adoption of the Market Behavior Rules, and the unique characteristics of electricity markets that do not have parallels in the securities industry, the Commission should

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<sup>7</sup> 97 FERC ¶ 61,220, at 61,976.

<sup>8</sup> See, e.g., *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004); and *PSEG Energy Resources & Trade, LLC v. FERC*, 360 F.3d 200 (D.C. Cir. 2004); *H.Q. Energy Services (U.S.), Inc. v. New York Independent System Operator, Inc.*, 110 FERC ¶ 61,243 (2005) and 113 FERC ¶ 61,184 (2005).

<sup>9</sup> EMA 2005 § 1283.



not simply import the bare language of SEC Rule 10b-5 into Part 47.<sup>10</sup> As the Commission stated in its recent Policy Statement on Enforcement: “the enhancement of our civil penalty authority does not mean that we will refrain from ordering the disgorgement of unjust profits or economic benefits that are the result of wrongdoing. To the contrary, companies will be expected to disgorge unjust profits whenever they can be determined or reasonably estimated.”<sup>11</sup> Accordingly, the Commission should add language to new Part 47 to make clear that the remedies for violation of Part 47 are not limited to the Commission’s civil penalty authority, but include the remedies the Commission has available to enforce its Market Behavior Rules. While violations of FPA § 222 would be subject to civil penalties under EMA 2005 § 1284(e), nothing in EMA 2005 limits the remedies for § 222 violations to civil penalties. To the contrary, EMA 2005 devolves broad authority on the Commission to issue implementing regulations. This addition would also make clear that the SEC precedent for Part 47 is not limited to the substantive standards (*i.e.*, scienter) for finding market manipulation, which has been the focus of the Commission’s references to the SEC in the Order. The history of SEC enforcement includes the use of disgorgement in numerous cases, whether this remedy was imposed by the SEC itself or by a federal court in response to an action filed by the SEC,<sup>12</sup> and has included both disgorgement and civil penalties.<sup>13</sup>

One of the purposes of the Market Behavior Rules was to put market participants on notice of the conduct that would be prohibited and subject to remedial action by the

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<sup>10</sup> Prohibition of Energy Market Manipulation, 70 Fed. Reg. 61,930 at 61,931 n.15.

<sup>11</sup> Policy Statement on Enforcement, Docket No. PL06-1-000 (oct. 20, 2005) at P 19.

<sup>12</sup> See, e.g., *In re Adams*, 2005 SEC LEXIS 3079 (Nov. 30, 2005); *In re Veras Capital Master Fund*, 2005 SEC LEXIS 3290 (Dec. 22, 2005); *In re Alcan*, 2004 SEC LEXIS 1422 (July 6, 2004); *SEC v. Materia*, 745 F.2d 197 (2nd Cir. 1984) (upholding district court’s disgorgement remedy for a violation of Section 10(b) of the Securities Exchange Act of 1934).

<sup>13</sup> *In re Veras Capital Master Fund*, 2005 SEC LEXIS 3290 (Dec. 22, 2005).

Commission.<sup>14</sup> Similarly, along with conduct standards, the Commission’s policy of remedial flexibility should be reflected in new Part 47.1 by the addition of a new section (b): “(b) An entity violating this Part shall be subject disgorgement of any unjust profit or other economic benefit resulting from such violation, and such other remedies or civil penalties as may be appropriate.”

As the record supporting the Market Behavior Rules shows, the stakes are too high not be clear on both the substantive and remedial scope of Part 47. For the same reason, there is no sufficient justification for removing the FPA §§ 205/206 protections provided by the Market Behavior Rules until the scope of the Commission’s substantive and remedial authority are established and tested under FPA § 222. Nothing in EMA 2005 or sound policy dictates departing from the prudent approach of keeping the Market Behavior Rules in place while the Commission, market participants, and if necessary the courts, gain experience with the Commission’s new statutory powers and related regulations.<sup>15</sup>

## **2. Imposing a Heightened Burden by Requiring Proof of Scienter Will Significantly Increase Enforcement Costs.**

As the Commission recognizes in paragraph 15 of its Order, the Commission’s proposal to eliminate the Market Behavior Rules and instead rely on its proposed 18 CFR Part 47 regulations will effectively remove the “due diligence” and “foreseeable” standards set forth in the Commission’s Market Behavior Rules. The Order states that the Commission intends to require a showing of scienter—“an intent to deceive, manipulate or defraud”—in order to find a

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<sup>14</sup> See Order on Rehearing, 107 FERC ¶ 61,175 P 15.

<sup>15</sup> While it is true that the Market Behavior Rules reach only entities with market-based rates, while § 222 extends to “any entity,” the Commission should not let the best be the enemy of the good.

violation of Part 47.<sup>16</sup> While a scienter requirement may be appropriate for the imposition of remedies, particularly civil penalties, for engaging in the conduct prohibited by § 222 and Part 47, that begs the question of the use of the Commission's FPA §§ 205/206 authority as implemented by the Market Behavior Rules to reach equally harmful conduct and the Commission's authority under §§ 205 and 206 to remedy such conduct without requiring a strict scienter showing. At least with regard to the very substantial portion of market conduct attributable to entities with market-based rate tariffs, there is no reason for the Commission voluntarily to accept a more stringent scienter standard before it requires disgorgement of profits that are shown to have been unjustly or unreasonably obtained. Nothing in EMA 2005 or sound policy forces the Commission to use § 222 to the exclusion of § 205 remedies pursuant to the Market Behavior Rules.

Under Market Behavior Rule 3 (for example), once an ISO/RTO or the OMOI shows that false or misleading information was submitted to (or that material information was omitted from a communication with) an ISO or RTO, the burden falls on the entity that submitted the information to show that it used due diligence to prevent a false or misleading submission. Under the scienter standard articulated by the Commission, the ISO/RTO or the OMOI would be required to prove that the market participant knowingly, intentionally or recklessly submitted false or misleading information before the Commission is able to impose a penalty. This significant change to the violation threshold will make formal discovery a virtual necessity in enforcement proceedings, greatly increasing the expected cost of enforcement for all parties involved (the ISO/RTO, the alleged wrongdoer and the Commission). This burden may be warranted under new FPA § 222, in view of the statutory mandate to follow SEC precedent, and

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<sup>16</sup> Order at P 15 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976)).

the potential for the imposition of civil penalties, among other remedies, for violations of § 222.<sup>17</sup> The fact remains that negligent submission of faulty data, or the submission of data without the exercise of the due diligent incumbent on good utility practice, can have the same consequences for markets and ratepayers as the submission of intentionally misleading data. To the extent that the Commission can continue to ensure that it has the authority to impose appropriate remedies for such conduct by retaining the Market Behavior Rules, it should do so. There is simply no reason to abandon that authority in the pursuit of new authority; there is simply no reason in EMA 2005 or sound policy why the two aspects of the Commission's authority cannot and should not co-exist.

### **3. Potential Inadequacy of Civil Penalties as Part 47 Remedies.**

The Market Behavior Rules authorize the Commission to require market-based rate sellers to disgorge unjustly obtained profits under Sections 205 and 206 of the FPA.<sup>18</sup> The Commission's new statutory civil penalty authority will permit the Commission to impose a civil penalty of up to \$1 million (per violation) per day. If a single deceptive or manipulative trade netted a market participant a profit of more than \$1 million, however, even the Commission's enhanced penalty authority will not be adequate to prevent the wrongdoer from being unjustly enriched. Unless and until it is firmly established that the Commission's remedial authority under § 222 includes disgorgement and other equitable remedies in addition to civil penalties, the Commission's FPA Section 205 authority as implemented by the Market Behavior Rules will continue to be the surest means available to the Commission to provide ratepayers a remedy against a wrongdoer that has been unjustly enriched by a market manipulation. Retaining the

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<sup>17</sup> EMA 2005 § 1284(e).

<sup>18</sup> See *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 97 FERC ¶ 61,220, at 61,976; 103 FERC ¶ 61,349, at 62,379-80; 105 FERC ¶ 61,218, at 62,164-69; *on reh'g*, 107 FERC ¶ 61,175, at 61,724-26.

Market Behavior Rules would ensure, at least as to the very substantial portion of market conduct attributable to entities with market-based rates tariffs, that there are no gaps in the Commission's ability to prevent wrongdoers from profiting by their manipulation of the markets that the Commission is responsible for safeguarding. Similarly, in going forward with new Part 47, the Commission needs to make clear, as recommended above, that the remedies for market manipulation are not limited to civil penalties, but can include disgorgement of unjust profits or other economic benefits. In the meantime, if indeed not indefinitely, the Market Behavior Rules should stay in place.

**4. Possible Inability to Use Civil Penalty Monies Collected to Compensate Victims of Market Manipulation.**

While the Commission clearly possesses the authority to require refunds under Sections 205 and 206 of the FPA be paid to the victims of market manipulation, the NYISO was not able to determine if the Commission has the discretion to use monies it receives in the form of civil penalties to compensate victims of market manipulation.<sup>19</sup> If the Commission is legally obligated to expend civil penalties monies in a particular way, or to pay them into a particular federal government account, then while the Commission may be able to penalize entities that engage in market manipulation, it will not have the ability to make victims of market manipulation whole. This underscores the need for the Commission to retain its Market

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<sup>19</sup> Section 316A of the Federal Power Act does not contain any specific directive regarding the use of penalty funds. Section 315 of that statute, which is the FPA's forfeiture provision, provides that monies forfeited under this section are payable to the U.S. Treasury. A recent order approved a settlement between a pipeline and FERC Staff regarding pre-Order No. 2004 standards of conduct issues that included a civil penalty that the pipeline was required to pay to the U.S. Treasury. According to the order, this penalty stemmed from the Natural Gas Policy Act's civil penalty provisions. *See The Williams Cos., Inc.*, 111 FERC ¶ 61,392 (2005). With respect to the SEC's civil penalty authority, in some cases civil penalties assessed by the SEC pursuant to its authority under the Securities and Exchange Act of 1934 have been paid directly to the SEC itself. The ultimate disposition of the civil penalty monies paid to the SEC is unclear.

Behavior Rules while implementing its new Part 47 rules, and to make clear that along with its civil penalty authority it also has broad remedial authority under Part 47 to order disgorgement or other appropriate remedies. There must not be any gaps in the Commission's ability to compensate victims of market manipulation in the markets that the Commission is responsible for safeguarding.

**5. Retaining the Market Behavior Rules Will Not Prevent Market Participants from Understanding or Complying with the Commission's Requirements.**

In paragraphs 12, 13, 14 and 24 of its Order, the Commission suggests that continuing the Market Behavior Rules after the Commission's Part 47 penalty provisions are implemented might make it difficult for market participants to "understand what behavior is proscribed and act accordingly" or would reduce "clarity and regulatory certainty." Both the Market Behavior Rules and the Part 47 regulations specifically identify the types of conduct that are prohibited. Market participants that are capable of implementing complex schemes to manipulate the electric markets that the Commission is charged with protecting are not likely to be befuddled by retaining the Market Behavior Rules. Both the Market Behavior Rules and Part 47 (with the additions recommended in these comments) are sufficiently clear to put market participants on notice of the prohibited conduct. Indeed, the Commission specifically so found in issuing the Market Behavior Rules, and surely intends its proposed Part 47 to serve the same function. Given the substantive concerns identified in these comments, speculation about unidentified sources of hypothetical confusion does not provide a sufficient policy justification for rescinding the Market Behavior Rules.

## **6. Market Behavior Rule 1 Is Not Superfluous and Should be Retained.**

Market Behavior Rule 1 requires entities holding market-based rate tariffs 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.” In paragraph 20 of its Order, the Commission suggests that Market Behavior Rule 1 is “a restatement of existing tariff obligations to comply with Commission rules and regulations in organized markets.” The Order goes on to state that: “These [the Commission rules and regulations in organized markets] 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.”

The Commission's statements, however, leave open the potential for gaps between the behavior required of market participants by ISO and RTO tariffs and the enforcement rights contained in those tariffs. That is, while the conduct requirements may be clear, the remedial consequences for violating those requirements may not be. Moreover, the Commission may determine that enforcement action may more appropriately lie with the Commission rather than an ISO or RTO. Any gaps between tariff obligations and tariff-based enforcement rights in organized markets can be avoided by continuing to require the inclusion of Market Behavior Rule 1 in the market-based rate tariffs of entities that transact in organized ISO/RTO markets.

At the same time, based on the NYISO's experience it is difficult to imagine any reason for deliberately not complying with the requirements of Market Behavior Rules 1—that is, with organized power markets rules and regulations—other than an effort to gain some undue market advantage. Thus, the Commission should incorporate the language of Market Behavior Rule 1 as a new numbered subparagraph in Part 47.1(a) that would make it “unlawful for any entity” “(3)

to operate or schedule generating facilities, undertake maintenance, declare outages, or commit or otherwise bid supply in a manner that does not comply with the Commission-approved rules and regulations of the applicable power market.”

**7. The Commission Should Incorporate the Qualification that No Action or Transaction Explicitly Contemplated By the Commission Rules, or Undertaken at the Direction of an ISO or RTO, is a Violation of the Proposed Part 47 Regulations.**

In paragraph 17 of the Order the Commission explains that under Market Behavior Rule 2, actions or transactions explicitly contemplated in the Commission-approved rules and regulations of an organized market, or undertaken by a market-based-rate seller at the direction of an ISO or RTO, are not violations of the Market Behavior Rule. The Commission states that it will also presume that transactions undertaken pursuant to the Commission-approved rules and regulations of an organized market, or pursuant to the direction of a Commission-approved RTO or ISO, present an affirmative defense to a claim of manipulation under the proposed Part 47 and seeks comment on whether it is necessary to retain this provision in the market-based rate tariffs. *See also*, paragraph 25(3) of the Order. To ensure clarity and certainty, the Commission should explicitly recognize the continuing validity of this affirmative defense, as it has done in its Order. This affirmative defense provides protection for market participants that parallels the protection for markets and ratepayers provided by Market Behavior Rule 1 and its analog in Part 47 recommended above.

It would also be appropriate to continue the “legitimate business purpose” defense now specified in Market Behavior Rule 2. Inclusion of this defense would ensure proper consideration of the economic, commercial and physical complexities of competitive energy markets, including such practices as valid arbitrage between real-time and forward markets. In addition, it would provide an appropriate means for considering differences between electric



markets and securities markets. While FPA §222 directs the Commission to be guided by SEC precedent in applying FPA §222, it is by no means clear, nor does the Order attempt to show, that there are no differences between electric markets and securities markets that should be considered in applying standards against market manipulation. Given that electricity is a commodity product with limited ability to be stored and that is moved over a non-switched network in accordance with certain laws of physics, none of which is true of securities, it seems unlikely that securities regulation precedent can be imported wholesale into the Commission's market oversight.

In furtherance of the clarity and certainty that Part 47 is intended to achieve, the availability of these affirmative defenses should be made explicit. Specifically, the Part 47.1 should include a new paragraph (c) providing that: "Actions or transactions explicitly contemplated in Commission-approved rules and regulations of an applicable power market or taken at the direction of an ISO or RTO, or undertaken for a legitimate business purpose, shall not be a violation of this Part."

**C. Responses to Questions Posed by the Commission in Paragraph 25 of the Order**

- 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?**

As the NYISO explains above, until the Commission and the participants and other stakeholders in the markets subject to the Commission's jurisdiction gain experience with the Commission's new authority under § 222 of the FPA and the substantive and remedial scope of that authority has been established, the Commission should not jettison the protections provided by its Market Behavior Rules under its existing FPA §§ 205 and 206 authority. Nothing in EMA

2005 compels this result, and hypothetical concerns about possible market participant confusion are not sufficient justification, particularly since the Commission has crafted the Market Behavior Rules and Part 47 to put market participants on notice of their obligations. While some standards for relief under the Market Behavior Rules may be less difficult to establish than under the Commission's proposed scienter requirement for Part 47, the Market Behavior Rules and Part 47 do not impose conflicting obligations, but rather a continuum of obligations not to manipulate markets. At the same, the arguably lower thresholds for certain kinds of relief under the Market Behavior Rules provide important market protections that were fully warranted when adopted and remain so now, notwithstanding the availability of other protections under Part 47. Correspondingly, in order to ensure that the new Part 47 regulations cover as much of the Market Behavior Rules as possible, Part 47 should be amended as discussed above. Part 47 should also be amended to make clear that the remedies available under Part 47 parallel those available under the Market Behavior Rules.

**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?**

Yes. See the NYISO's response to Question No. II.C.1 and discussion of Issue Nos. II.B.1 through II.B.5, above.

**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?**

Yes. See the NYISO's discussion of Issue No. III.B.7, above.

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

Yes. See the NYISO's discussion of Issue No. III.B.7, above.

**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?**

Yes, given the differing standards of proof that apply to Market Behavior Rule 3 and the Commission's Proposed 18 CFR Part 47 regulations. There certainly can be false or misleading communications that would not satisfy a scienter standard, and thus would not qualify as an actionable fraud or deceit under Part 47, but could nonetheless cause substantial harm and should be subject to the Commission's remedial authority.

The NYISO is particularly concerned about the proposed elimination of Market Behavior Rule Nos. 2(b) and 3 that address market participants' obligation to provide accurate and sufficient information to the Commission, and to ISOs and RTOs. The Commission should not limit its ability to enforce the obligation to provide accurate, sufficient and adequate information to ISOs/RTOs or to the Commission itself to entities that have intentionally, knowingly or recklessly submitted inaccurate data, provided misleading data or omitted material information. Instead, the Commission should continue to require the incorporation of these Market Behavior Rules in market-based rate tariffs, retaining the "foreseeable" and "due diligence" standards of proof that apply to violations of these Market Behavior Rules.

If the Commission requires the ISOs/RTOs and/or its OMOI to show, in each instance, that a market participant that submitted false or misleading information (or that omitted material facts from its submission) did so intentionally, knowingly or recklessly before it is able to take enforcement action against the market participant, expected enforcement costs will be greatly increased for all parties involved (the ISO/RTO, the alleged wrongdoer and the Commission). Instead, the Commission should require jurisdictional sellers with market-based rate tariffs that

submitted false or misleading data, or that failed to provide material information, to show that they used due diligence to ensure that they were providing accurate data to the ISO/RTO.

- 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?**

Yes. See the NYISO's response to Question No. III.C.5, above.

- 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?**

Yes, to the extent that a scienter requirement would make the application of Part 47 more stringent or difficult than intended by Market Behavior Rule 6.

#### **IV. NOTICES AND COMMUNICATIONS**

Communications regarding this proceeding should be addressed to:

Robert E. Fernandez  
General Counsel and Secretary  
Elaine Robinson  
Director of Regulatory Affairs  
Alex M. Schnell  
New York Independent System Operator, Inc.  
10 Krey Boulevard  
Rensselaer, NY 12144  
Tel: (518) 356-8707  
Fax: (518) 356-8825  
rfernandez@nyiso.com  
erobinson@nyiso.com  
aschnell@nyiso.com

William F. Young  
Hunton & Williams LLP  
1900 K St., N.W.  
Washington, D.C.  
Tel: (202) 955-1684  
Fax: (202) 828-3740  
  
J. Kennerly Davis  
Hunton & Williams LLP  
Riverfront Plaza, East Tower  
951 East Byrd Street  
Richmond, VA 23219-4074  
Tel: (804) 788-8559  
Fax: (804) 788-8218  
kdavis@hunton.com

## V. CONCLUSION

For the reasons set forth in detail above, the NYISO respectfully requests that:

1. the Commission grant its motion to intervene in this proceeding;
2. the Commission continue to condition its acceptance of market-based rate tariffs on the inclusion of the Market Behavior Rules; and
3. the Commission grant any and all other relief sought or requested in the NYISO's comments.

Respectfully Submitted

/s/ Alex M. Schnell  
Robert E. Fernandez  
Alex M. Schnell  
New York Independent System Operator, Inc.  
10 Krey Boulevard  
Rensselaer, NY 12144

Date: December 29, 2005

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each party designated on the official service list compiled by the Secretary in Docket No. EL06-16 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2005).

Dated at Washington, D.C., this 29<sup>th</sup> day of December, 2005.

/s/ Cathy Karimi  
Hunton & Williams LLP  
1900 K Street, N.W.  
Washington, DC 20006-1109  
(202) 955-1500

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