

**Chairman Kelliher's Statement
on Agenda Items M-1, M-2 and M-4
Meeting of the Federal Energy Regulatory Commission
October 20, 2005**

“As we prepare for a winter of unprecedented home heating costs, the Commission is determined to ensure that prices do not rise higher still because of market manipulation.

“Today, I am pleased that the Commission takes a significant step forward toward exercising our new authority under the Energy Policy Act of 2005 to prevent market manipulation. We take this step firmly, and carefully.

“As Congress instructed, today's anti-manipulation Notice of Proposed Rulemaking is modeled closely on Securities and Exchange Commission rules implementing section 10(b) of the 1934 Securities Exchange Act. We studied that model and how the SEC has implemented it over the years, and adapted it where necessary to our legal construct. We also reviewed the anti-manipulation provisions in commodities law, which are also modeled on the securities law construct. Our proposed approach will provide the industry with regulatory certainty, since there is a substantial body of precedent applying the comparable language in the realm of securities and commodities.

“Today we are proposing that it shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or transmission services subject to Commission jurisdiction, or the purchase or sale of natural gas or transportation service subject to Commission jurisdiction, to:

- use or employ any device, scheme, or artifice to defraud;
- make material false statements or omit material facts; or
- engage in any act, practice, or course of business that operate or would operate as a fraud or deceit upon any person.

“We propose to apply the manipulation rules consistent with SEC precedent. That embodies the “scienter” precedent, which the Supreme Court has defined as “a mental state embracing intent to deceive, manipulate or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

“I would underscore that, true to the Energy Policy Act, these rules will apply to “any entity” – not just the public utilities and natural gas companies we have traditionally regulated. These rules will apply to government-owned utilities and any other market participants.

“This is not the first step the Commission has taken to prevent market manipulation. The Commission acted two years ago, issuing Market Behavior Rules to prevent market manipulation in electricity and gas markets. However, those rules have been subject to legal challenge. That

is in part why I asked Congress to establish an express prohibition of market manipulation – to guard against this legal challenge.

“We intend to move swiftly to issue a final rule implementing the anti-manipulation provisions Congress provided. In the interim, I would remind regulated entities that the Market Behavior Rules remain in effect. However, the NOPR recognizes that, with the new authority granted by Congress, the Commission should consider whether to revise or repeal Market Behavior Rule 2. We intend to initiate such an inquiry in the very near future and to swiftly resolve that issue. This also will provide the industry significantly greater certainty than exists today.

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“Also today, with M-2 on our agenda, we act to clarify our enforcement policy. Again, we have been careful. We have reviewed how other regulatory bodies with enforcement authority implement their authority, and the Policy Statement draws from the experience of agencies, such as the SEC and CFTC. We were also guided by a January 2003 Justice Department memorandum establishing principles to guide federal prosecutions of business organizations.

“Our purpose is firm but fair enforcement of our rules and regulations. I want to be clear: the Commission’s goal is compliance. We have a duty to be clear on what the rules are. Compliance should not be elusive, it should not be subjective, and it should be objective to the greatest extent possible.

“Our goal is to facilitate compliance – and to quickly identify and sanction noncompliance.

“The Enforcement Policy Statement encourages compliance by making plain the factors that will be considered in applying remedies for violations, including the imposition of the Commission’s enhanced civil penalty authority.

“We encourage regulated entities to develop and maintain strong compliance programs and develop a compliance culture. Among the factors that will be considered under the Enforcement Policy Statement are:

- the existence of effective compliance programs,
- self-reporting of violations,
- level of cooperation in Commission enforcement actions,
- the company’s compliance history,
- whether the violation related to actions by senior management,
- whether the violation was willful,
- the harm caused by the violation.

“Under the Enforcement Policy Statement, if two different entities commit the same violation, and one entity has an effective compliance program, self-reported the violation, took remedial action, cooperated with the Commission’s investigation, and the violation was an isolated instance, and the second entity had no compliance program, its senior management learned of the

violation but took no action, the entity had a history of violations, and failed to cooperate with the investigation, the civil penalties levied would be substantially different.

“Our hope is the Enforcement Policy Statement will encourage regulated entities to establish and maintain effective compliance programs.

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“A related order, M-4, is a proposed rule to amend Commission rules to permit any person subject to a Commission audit to challenge audit findings and proposed remedies. As it currently stands, only persons subject to financial audits have the right to challenge audit findings. The proposed rule would extend that right to persons subject to operational audits under the FPA designed to determine compliance with Standards of Conduct, Code of Conduct, market-based rates, and other Commission requirements, as well as persons subject to audits under the Natural Gas Policy Act and Interstate Commerce Act. The goal of this order is to assure fairness towards persons subject to Commission audits.”