

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Parts 47 and 159

(Docket No. RM06-3-000)

Prohibition of Energy Market Manipulation

(Issued October 20, 2005)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: Pursuant to Title III, Subtitle B, and Title XII, Subtitle G of the Energy Policy Act of 2005, the Federal Energy Regulatory Commission (Commission) is proposing rules to implement new section 222 of the Federal Power Act and new section 4A of the Natural Gas Act, prohibiting the employment of manipulative or deceptive devices or contrivances. The Commission seeks public comment on the regulations proposed herein.

DATES: Comments are due **[insert date 21 days after publication in the FEDERAL REGISTER]**. Reply comments are due **[insert date seven days after comment date]**.

ADDRESSES: Comments may be filed electronically via the eFiling link on the Commission's web site at <http://www.ferc.gov>. Commenters unable to file comments electronically must send an original and 14 copies of their comments to: Federal Energy Regulatory Commission, Office of the Secretary, 888 First Street N.E., Washington, D.C. 20426. Refer to the Comment Procedures section of the preamble for additional information on how to file comments.

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SUPPLEMENTARY INFORMATION:

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Prohibition of Energy Market Manipulation

Docket No. RM06-3-000

NOTICE OF PROPOSED RULEMAKING

(Issued October 20, 2005)

**Introduction**

1. On August 8, 2005, the Energy Policy Act of 2005 (EPAct 2005)<sup>1</sup> was signed into law. Sections 315 and 1283 of EPAct 2005, amending the Natural Gas Act<sup>2</sup> and the Federal Power Act,<sup>3</sup> respectively, are virtually identical, and prohibit the use or employment of manipulative or deceptive devices or contrivances in connection with the purchase or sale of natural gas, electric energy, or transportation or transmission services subject to the jurisdiction of the Commission. These anti-manipulation sections of EPAct 2005 closely track the prohibited conduct language in section 10(b) of the Securities Exchange Act of 1934,<sup>4</sup> and specifically dictate that the terms “manipulative or deceptive device or contrivance” are to be used “as those terms are used in section 10(b).”

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<sup>1</sup> Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

<sup>2</sup> 15 U.S.C. § 717 et al. (2004).

<sup>3</sup> 16 U.S.C. § 791a et al. (2004).

<sup>4</sup> Securities and Exchange Act of 1934, 15 U.S.C. 78j(b) (2005) (Exchange Act).

2. The Securities and Exchange Commission (SEC) has adopted Rule 10b-5,<sup>5</sup> which implemented section 10(b) of the Exchange Act, and has developed a significant body of legal precedent related to both section 10(b) of the Exchange Act and Rule 10b-5.

Consistent with the mandate that the Commission's new authority be exercised in a manner consistent with section 10(b) of the Exchange Act, the Commission has modeled its proposed regulations on Rule 10b-5.<sup>6</sup> This approach should provide benefits to entities subject to the new rule because there is a substantial body of precedent applying the comparable language of Rule 10b-5.

3. In this Notice of Proposed Rulemaking (NOPR), the Commission proposes to add a Part 47 under Subchapter B (Regulations under the Federal Power Act) and a Part 159 under Subchapter E (Regulations under the Natural Gas Act) to Title 18 of the Code of Federal Regulations, and intends to issue final regulations by **[December 31, 2005]**. The Commission seeks comments on its proposals for the regulations discussed below.

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<sup>5</sup> 17 CFR 240.10b-5 (2005).

<sup>6</sup> This reliance on the use of SEC precedent is consistent with Congress' expressed intent in sections 315 and 1283 that any "manipulative or deceptive device or contrivance" is prohibited "as those terms are used in section 10(b) of the Securities and Exchange Act of 1934" and Congress' modeling sections 315 and 1283 of EPAct 2005 after section 10(b) of the Exchange Act.

**Background**

4. In November 2003, the Commission issued the Market Behavior Rules to fill a void in the regulation of market-based trading activity.<sup>7</sup> The Market Behavior Rules emanated from the Commission's investigation of trading activity in Western markets during 2000-2001, which uncovered a number of trading schemes intended to take advantage of the then-existing electricity market in California.<sup>8</sup> The Commission also discovered abuses in reporting of natural gas prices to price index publishers for purposes of manipulating price indices.<sup>9</sup>

5. The Market Behavior Rules were adopted to establish guidelines applicable to the conduct of jurisdictional market-based rate sellers in wholesale power markets and to

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<sup>7</sup> Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, "Order Amending Market-Based Rate Tariffs and Authorizations," 105 FERC ¶ 61,218 (2003), reh'g denied, 107 FERC ¶ 61,175 (2004); Order No. 644, Amendment to Blanket Sales Certificates, FERC Stats. & Regs. ¶ 31,153 (2003), reh'g denied, 107 FERC ¶ 61,174 (2004).

<sup>8</sup> See Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003) (Final Report); see also American Elec. Power Serv. Corp., 103 FERC ¶ 61,345 (2003), reh'g denied, 106 FERC ¶ 61,020 (2004); Enron Power Mktg., Inc., 103 FERC ¶ 61,346 (2003), reh'g denied, 106 FERC ¶ 61,020 (2004).

<sup>9</sup> Final Report, Docket No. PA02-2-000 (March 2003); Policy Statement on Natural Gas and Electric Price Indices, 104 FERC ¶ 61,121 at 61,404 (2003) (addressing price index reporting abuses).

jurisdictional companies engaged in wholesale sales of natural gas under blanket certificate authority.

6. An important provision of the Market Behavior Rules is Rule 2, which states that “[a]ctions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited.”<sup>10</sup> In addition, Market Behavior Rule 2(a) expressly prohibits wash trades, Rule 2(b) prohibits transactions predicated on submitting false information, Rule 2(c) prohibits creating and relieving artificial congestion, and Rule 2(d) prohibits collusion.<sup>11</sup>

7. Sections 315 and 1283 of EPAct 2005 enhance the Commission’s authority to prohibit manipulation of the energy markets. However, neither section 315 nor 1283 is a

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<sup>10</sup> Investigations of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 at Appendix A (2003). Sections 284.288(a) and 284.403(a) of the Commission’s regulations, promulgated in Order No. 644, contain substantially similar language: a pipeline that provides unbundled natural gas service under section 284.284 or any person making natural gas sales for resale in interstate commerce pursuant to section 284.402 “is prohibited from engaging in actions or transactions that are without a legitimate business purpose and are intended to or foreseeably could manipulate market prices, market conditions, or market rules for natural gas.” The Market Behavior Rules are currently being appealed. See Cinergy Mktg. & Trading, L.P. v. FERC, Docket No. 04-1168 et al. (D.C. Cir. 2005).

<sup>11</sup> Order No. 644 expressly prohibits wash trades and collusion for natural gas sellers.

self-actuating provision. This rulemaking fulfills Congress' intent in adopting these provisions.

### **The Commission's Proposed Regulations**

8. Pursuant to section 4A of the Natural Gas Act and section 222 of the Federal Power Act, as added to the statutes by EPAct 2005, the Commission proposes to add a Part 47 under Subchapter B and a Part 159 under Subchapter E to Title 18 of the Code of Federal Regulations. Under these proposed regulations, it shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, or in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, (1) to use or employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person.

9. Sections 315 and 1283 of EPAct 2005 apply to "any entity." Indeed, section 1283 expressly includes an "entity described in section 201(f)." Accordingly, these proposed regulations apply to the conduct of "any entity," not just jurisdictional market-based rate sellers, natural gas pipelines, or holders of blanket certificate authority. "[A]ny entity"

includes not only regulated utilities but also governmental utilities and other market participants.<sup>12</sup>

10. As discussed in more detail below, subsections (a) (1)-(3) of these proposed regulations are patterned after the SEC's Rule 10b-5, and are intended to be interpreted consistent with analogous SEC precedent that is appropriate under the circumstances. Subsection (b) of the Commission's proposed regulations states that nothing in these provisions shall be construed to create a private right of action.<sup>13</sup> This language is based expressly on sections 315 and 1283 of EPCA 2005, and reflects Congress' intent that entities will not be subject to civil actions by third parties based on alleged violations of these proposed regulations.

### **Securities and Commodity Law Precedent**

11. The Exchange Act addresses regulation of the securities markets. One of the most important provisions of the Exchange Act is section 10(b), which prohibits the use of

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<sup>12</sup> The Commission intends that the principles discussed in the Policy Statement on Enforcement that we are issuing today in Docket No. PL06-1-000 will also apply to "any entity" as defined herein.

<sup>13</sup> However, subsection (b) is not intended to take away any other right that may otherwise exist.

“any manipulative or deceptive device or contrivance” in contravention of SEC Rules.<sup>14</sup>

The SEC promulgated Rule 10b-5 to enforce section 10(b).<sup>15</sup>

12. Section 10(b) and Rule 10b-5 might “well be the most litigated provisions in the federal securities laws,”<sup>16</sup> having been described by the Supreme Court as “a judicial oak which has grown from little more than a legislative acorn.”<sup>17</sup> The vast body of section 10(b) case law provides substantial certainty to entities subject to section 10(b) because it has resolved many recurring questions of interpretation that have arisen under the rule.

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<sup>14</sup> 15 U.S.C. § 78j(b) (2005).

<sup>15</sup> Rule 10b-5 of the U.S. Securities and Exchange Commission reads:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

<sup>17</sup> CFR 240.10b-5 (2005).

<sup>16</sup> SEC v. National Sec., Inc., 393 U.S. 453, 465 (1969).

<sup>17</sup> Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975); see also Louis Loss & Joel Seligman, Securities Regulations § 9-B-3 (3d. ed. 2004) (regarding Rule 10b-5 “[i]t is difficult to think of another instance in the entire corpus juris in which the interaction of the legislative, administrative rulemaking, and judicial processes has produced so much from so little.”).

13. Section 4b of the Commodity Exchange Act (CEA) is the Commodity Futures Trading Commission's (CFTC) general anti-fraud rule.<sup>18</sup> Section 4b makes it unlawful for any person to "cheat or defraud or attempt to cheat or defraud," or to make false reports or statements, or to deceive or attempt to deceive another in transactions under the CFTC's jurisdiction. Although the statutory language of section 10(b) of the Exchange Act and section 4b of the CEA are not identical, the Supreme Court stated that they are "analogous" and "[t]he language of § 4b [of the CEA] is similar to that of § 10(b) of the Securities Exchange Act of 1934."<sup>19</sup> Lower courts have gone further, noting that "the elements of a claim under § 4(b)(A) are basically the same as those under Rule 10b-5."<sup>20</sup>

14. The Commission proposes to pattern proposed sections 47.1 and 159.1 of its regulations on the text of Rule 10b-5. This is not only consistent with the clear intent of sections 315 and 1283 of EAct 2005, but also should benefit the industry because it will provide greater certainty to entities subject to the new rules because the Commission

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<sup>18</sup> 7 U.S.C. § 6b (2005).

<sup>19</sup> Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 389 (1982).

<sup>20</sup> Trustman v. Merrill Lynch, Pierce, Fenner & Smith, 1985 U.S. Dist. LEXIS 23154 at \*38; Fed. Sec. L. Rep. (CCH) P91,936 (C.D.C.A. 1985); see also, Drexel Burnham Lambert, Inc. v. Commodity Futures Trading Comm'n, 850 F.2d 742, 748 (D.C. Cir. 1988) (court held recklessness satisfied the scienter requirement for section 4b just as it does under section 10(b) and Rule 10b-5).

intends to rely on the large body of case law interpreting and applying section 10(b) and Rule 10b-5 when applying its new authority.<sup>21</sup>

### **The Relationship of the Proposed Rules to the Commission's Market Behavior Rules**

15. Both Market Behavior Rule 2 and the proposed regulations prohibit manipulative conduct. For now, Market Behavior Rule 2 is retained, an approach consistent with that taken by both the SEC and CFTC.<sup>22</sup> However, the Commission will address the possibility of revising or repealing Market Behavior Rule 2, and will seek comments in the near future. Moreover, as explained in the concurrent Policy Statement on Enforcement that we are issuing today (discussed below), we will not seek duplicative

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<sup>21</sup> EPAAct 2005, with its references to Section 10(b) of the Exchange Act, provides a level of substantial certainty with respect to how the proposed regulations will operate that the Commission is not typically able to provide where a preexisting body of law and precedent is not readily available.

<sup>22</sup> For example, section 10(b) and Rule 10b-5, the SEC's general anti-fraud provision (the Supreme Court described section 10(b) as a "general prohibition of practices...artificially affecting market activity in order to mislead investors" designed as a broad anti-fraud "catch-all clause." Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 6-7 (1985); Aaron v. SEC, 446 U.S. 680, 690 (1980)), exists alongside other, more targeted provisions, including but not limited to: section 9(a)(2) prohibiting manipulative conduct on national securities exchanges (15 U.S.C. § 78i (2005)); section 14(e) prohibiting any person from making material misstatements or omissions and from engaging in fraudulent conduct in connection with any tender offer (15 U.S.C. § 78n(e) (2005)); and section 17(a) prohibiting fraud in connection with the sale of securities (15 U.S.C. § 77q(a) (2005)). Similarly, the CFTC's general anti-fraud provision in section 4b exists alongside other CFTC anti-manipulation provisions, including but not limited to: section 4o prohibiting fraud by commodity trading advisors and commodity pool operators (7 U.S.C. § 6m (2005)); Rule 30.9 prohibiting fraud in connection with foreign futures contracts (17 CFR 30.9 (2005)); and Rule 32.9 prohibiting fraud in connection with commodity option transactions (17 CFR 32.9 (2005)).

sanctions for the same conduct in the event that conduct violates both Market Behavior Rule 2 and proposed section 47.1.<sup>23</sup>

### **Concurrent Policy Statement on Enforcement**

16. The Commission's new EAct 2005 authority under the anti-manipulation provisions coupled with expanded civil penalty authority,<sup>24</sup> provides us with more effective tools to assure workably competitive markets. The Commission is concurrently issuing a Policy Statement on Enforcement that sets out guidelines on the Commission's enforcement policies and practices and on how we will exercise our new civil penalty authority.<sup>25</sup> The Policy Statement, like these new proposed regulations, draws from the experience of other federal agencies, including the SEC and the CFTC, in explaining the factors that will be taken into account in applying remedies for misconduct, including the imposition of civil penalties. The Policy Statement provides that the Commission will exercise its enhanced authority in a firm but fair manner, and will take mitigating factors into account in resolving violations.<sup>26</sup>

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<sup>23</sup> The Commission will likewise not seek duplicative sanctions from natural gas sellers for the same conduct in the event that conduct violates both the Market Behavior Rules, 18 C.F.R. § 284.288(a) or 284.403(a) (2005), and proposed section 159.1.

<sup>24</sup> Sections 314 and 1284 of EAct 2005.

<sup>25</sup> Policy Statement on Enforcement, Docket No. PL06-1-000.

<sup>26</sup> Id.

**Information Collection Statement**

17. This proposed rule implements the existing requirements as set forth in sections 315 and 1283 of EPCRA 2005 and does not include new information requirements under the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501 et seq.).

**Environmental Analysis**

18. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.<sup>27</sup> The Commission has categorically excluded certain actions from these requirements as not having a significant effect on the human environment.<sup>28</sup> The actions proposed here fall within categorical exclusions in the Commission's regulations for rules that are clarifying, corrective, or procedural, for information gathering, analysis, and dissemination, and for sales, exchange, and transportation of electric power that requires no construction of facilities.<sup>29</sup> Therefore, an environmental assessment is unnecessary and has not been prepared in this NOPR.

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<sup>27</sup> Order No. 486, Regulations Implementing the National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,783 (1987).

<sup>28</sup> 18 CFR 380.4 (2005).

<sup>29</sup> See 18 CFR 380.4(a)(2)(ii), 380.4(a)(5), 380.4(a)(27) (2005).

**Regulatory Flexibility Act**

19. The Regulatory Flexibility Act of 1980 (RFA)<sup>30</sup> generally requires a description and analysis of final rules that will have significant economic impact on a substantial number of small entities.<sup>31</sup> The Commission is not required to make such analyses if a rule would not have such an effect.

20. The Commission does not believe that this proposed rule would have such an impact on small entities. This proposed rule prohibits all entities, including small entities, from employing manipulative or deceptive devices or contrivances, and therefore may cause entities, including potentially small entities, to increase costs in order to comply. This prohibition, however, will improve market transparency to the economic benefit of all entities, including small entities. Therefore, the Commission certifies that this proposed rule, if finalized, will not have a significant economic impact on a substantial number of small entities.

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<sup>30</sup> 5 U.S.C. § 601-12 (2000).

<sup>31</sup> The RFA definition of “small entity” refers to the definition provided in the Small Business Act, which defines a “small business concern” as a business that is independently owned and operated and that is not dominant in its field of operation. 15 U.S.C. § 632 (2000). The Small Business Size Standards component of the North American Industry Classification System defines a small electric utility as one that, including its affiliates, is primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and whose total electric output for the preceding fiscal years did not exceed 4 million MWh. 13 CFR 121.201 (2004) (Section 22, Utilities, North American Industry Classification System, NAICS).

**Comment Procedures**

21. The Commission invites interested persons to submit comments on the matters and issues proposed in this notice to be adopted, including any related matters or alternative proposals that commenters may wish to discuss. Comments are due **[INSERT DATE 21 days from publication in the FEDERAL REGISTER]**. Reply comments are due seven days thereafter. Comments must refer to Docket No. RM06-3-000, and must include the commenter's name, the organization they represent, if applicable, and their address in their comments. Comments may be filed either in electronic or paper format.
22. Comments may be filed electronically via the eFiling link on the Commission's web site at <http://www.ferc.gov>. The Commission accepts most standard word processing formats and commenters may attach additional files with supporting information in certain other file formats. Commenters filing electronically do not need to make a paper filing. Commenters that are not able to file comments electronically must send an original and 14 copies of their comments to: Federal Energy Regulatory Commission, Office of the Secretary, 888 First Street N.E., Washington, D.C. 20426.
23. All comments will be placed in the Commission's public files and may be viewed, printed, or downloaded remotely as described in the Document Availability section below. Commenters on this proposal are not required to serve copies of their comments on other commenters.

**Document Availability**

24. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page

<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington, D.C. 20426.

25. From FERC's Home Page on the Internet, this information is available in the eLibrary. The full text of this document is available in the eLibrary both in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

26. User assistance is available for eLibrary and the FERC's website during our normal business hours. For assistance contact FERC Online Support at [FERCOnlineSupport@ferc.gov](mailto:FERCOnlineSupport@ferc.gov) or toll-free at (866)208-3676, or for TTY, contact (202)502-8659.

List of subjects

18 CFR Part 47

Electric utilities, Electric power, Investigations, Penalties

18 CFR Part 159

Natural Gas, Pipelines, Investigations, Penalties

By direction of the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.

In consideration of the foregoing, the Commission proposes to amend Chapter I, Title 18, Code of Federal Regulations, as follows:

1. Part 47 is added to read as follows:

**PART 47 - - PROHIBITION OF ENERGY MARKET MANIPULATION**

Authority: 16 U.S.C. 791-825r, 2601-2645; 42 U.S.C. 7101-7352.

**§ 47.1 Prohibition of Energy Market Manipulation.**

(a) It shall be unlawful for any entity, directly or indirectly,

(1) to use or employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission.

(b) Nothing in this § 47.1 shall be construed to create a private right of action.

2. Part 159 is added to read as follows:

**PART 159 - - PROHIBITION OF ENERGY MARKET MANIPULATION**

Authority: 15 U.S.C. 717-717z; 42 U.S.C. 7101-7352.

**§ 159.1 Prohibition of Energy Market Manipulation.**

(a) It shall be unlawful for any entity, directly or indirectly,

(1) to use or employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission.

(b) Nothing in this § 159.1 shall be construed to create a private right of action.