

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Prohibition of Energy Market Manipulation

Docket No. RM06-3-000

FILED
OFFICE OF THE
SECRETARY
2005 DEC -5 P 4: 49
FEDERAL ENERGY
REGULATORY COMMISSION

**REPLY COMMENTS OF THE INTERNATIONAL SWAPS
AND DERIVATIVES ASSOCIATION, INC.**

The International Swaps and Derivatives Association, Inc. (“ISDA”) hereby submits these reply comments in response to the Federal Energy Regulatory Commission’s (the “Commission”) Notice of Proposed Rulemaking on the Prohibition of Energy Market Manipulation published on October 27, 2005 (the “NOPR”).¹

ISDA reiterates its position that the Commission should limit market participants’ duty to disclose in order to avoid substantially increasing the very uncertainty the Commission is attempting to eliminate. The Commission should state explicitly that the material omission standard in the proposed rule applies only to communications with the Commission and to its delegates as set forth in current Market Behavior Rule 3. ISDA also supports the Commission’s adoption of a scienter requirement. Lastly, ISDA suggests that the Commission issue a new notice of proposed rulemaking to consider implementing a Wells-type process similar to those used at other agencies prior to initiating any enforcement proceedings.

¹ *Prohibition of Energy Market Manipulation*, 70 Fed. Reg. 61,930 (Oct. 27, 2005).

II. REPLY COMMENTS

In their initial comments, ISDA and several other parties noted the very material differences between the securities markets and wholesale energy commodities markets.² Because of these differences, ISDA and others raised a concern over the application of the second prong in the proposed regulations (*i.e.*, misrepresentation or omission of material facts) to the wholesale energy commodities markets. These parties noted that the second prong of Rule 10b-5 is limited to those instances in which there is a duty to disclose.³

ISDA and others requested that the Commission clarify market participants' disclosure obligations and not adopt all of the SEC's Rule 10b-5 precedent dealing with disclosure because much of it will be inapposite to the relationship between parties in the wholesale commodities markets.⁴ Other parties asked that the Commission eliminate the second prong of the proposed regulations altogether.⁵ If the Commission retains this prong of the proposed regulations, the disclosure obligations should be clarified because some market participants may incorrectly assume the existence of disclosure obligations in the context of bilateral negotiations with counterparties to a wholesale energy transaction.

² See, e.g., Comments of the International Swaps and Derivatives Association, Inc., Docket No. RM06-3, at 4-5 (Nov. 17, 2005) ("ISDA Comments"); Initial Comments of the Edison Electric Institute, Docket No. RM06-3, at 7-10 (Nov. 17, 2005) ("EEI Comments"); Comments of the Electric Power Supply Association on Proposed Rules Prohibiting the Employment of Manipulative and Deceptive Devices and Contrivances, Docket No. RM06-3, at 5-9 (Nov. 17, 2005) ("EPSA Comments"); Comments of Constellation Energy Group, Inc., DTE Energy Company and Sempra Energy on Proposed Rule on Prohibition of Energy Market Manipulation, Docket No. RM06-3, at 10-13 (Nov. 17, 2005); Southern California Edison Company's Comments in Response to Notice of Proposed Rulemaking Regarding Prohibition of Energy Market Manipulation, Docket No. RM06-3, at 3-4 (Nov. 17, 2005); Comments of LG&E Energy LLC, Docket No. RM06-3, at 4-5 (Nov. 17, 2005); Comments of Pacific Gas and Electric Company, Docket No. RM06-3, at 7-12 (Nov. 17, 2005).

³ See ISDA Comments at 7-8.

⁴ ISDA Comments at 4, 6-8; EPSA Comments at 5-10; EEI Comments at 14 ("At the very least, the affirmative obligation to disclose information to a counterparty must be excluded or substantially limited.").

⁵ EPSA Comments at 7; see also EEI Comments at 16 (requesting the Commission to eliminate reference to omission of material facts).

A. The Commission Should Clarify the Standard for Misrepresentations or Omissions by Limiting the Duty to Disclose to the Entities Specified in Market Behavior Rule 3

The Commission has consistently and repeatedly emphasized that its goal in this NOPR, and in its subsequent order proposing to repeal the Market Behavior Rules, is to “provide greater certainty to entities subject to the new rule.”⁶ The Commission also intends to provide rules that are “as clear as possible so that market participants . . . understand what conduct is proscribed and can act accordingly.”⁷ The Commission stated its belief that repealing the Market Behavior Rules “will simplify the Commission’s rules and regulations, avoid confusion, and provide greater clarity and regulatory certainty to the industry.”⁸ But the Commission has now proposed to repeal Market Behavior Rule 3, which appropriately limits disclosure obligations to the Commission and certain related entities. The Commission should provide market participants with the intended (and needed) clarity and certainty by limiting market participants’ duty to disclose to the entities specified in Market Behavior Rule 3.

After the initial comments were filed in this proceeding, the Commission proposed repealing the existing Market Behavior Rules once the proposed Part 47 regulations are in place.⁹ In that order, the Commission stated its view that Market Behavior Rules 2 and 3 overlap with the “expanded anti-manipulation authority” under proposed Part 47.¹⁰ Unlike the proposed regulations, Market Behavior Rule 3 specifies the entities to which sellers have a duty to communicate accurate information: “the Commission, Commission-approved market monitors,

⁶ NOPR at P 14.

⁷ *Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations*, 70 Fed. Reg. 71,484, at P 12 (Nov. 29, 2005) (“MBR Order”).

⁸ MBR Order at P 13.

⁹ *Id.* at P 12.

¹⁰ *Id.* at PP 13-14.

Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers.”

Clarifying the situations in which wholesale energy market participants have a duty to disclose information will help to provide certainty to market participants, and providing certainty is the Commission’s stated goal in enacting Part 47 and repealing the Market Behavior Rules.¹¹ With such clarification in the regulations, market participants will know to whom they owe a duty to disclose information. If the Commission does not appropriately limit application of the regulations, some market participants may misapprehend that there are disclosure requirements in the context of bilateral negotiations and assert that all information material to the negotiations must be disclosed to a counterparty.¹²

This confusion is unnecessary and may be avoided by providing a simple clarification that specifies that (1) market participants have no duty to disclose information other than to “the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers,” and (2) existing statutes and Commission regulations specify what information must be disclosed.¹³

B. ISDA Supports Adoption of a Scierter Requirement For Part 47 Cases

In the Market Behavior Rule order, the Commission noted that Rule 2 has a “foreseeability” standard, which “has generated controversy and uncertainty,” and does not

¹¹ NOPR at P 14; MBR Order at P 13.

¹² See Comments of SUEZ Energy North America, Inc., Docket No. RM06-3, at 12 (Nov. 17, 2005) (requesting that the Commission reconsider whether to impose a requirement “that all material facts be disclosed in connection with every wholesale electric and gas transaction or transmission/transportation services transaction”).

¹³ In addition, the Commission should carefully review SEC precedent dealing with disclosure issues before looking to it for precedential value. As ISDA and other commentators explained in their initial comments, there are fundamental differences between the securities markets and the wholesale energy commodities markets. These differences make much of the SEC Rule 10b-5 precedent dealing with disclosure inapposite.

include a scienter requirement.¹⁴ The Commission indicated its intent to “require a showing of scienter, that is, an intent to deceive, manipulate or defraud” in cases under Part 47 of its regulations.¹⁵ ISDA supports adoption of a scienter requirement that requires a showing of actual intent and urges the Commission to clarify that negligent or reckless conduct is insufficient to show actual intent.

C. The Commission Should Clarify the Process for Investigations and Enforcement Actions Under Part 47 in a Separate Proceeding

ISDA supports the suggestion by one commentator that the Commission implement a Wells-like procedure similar to that used by other administrative agencies with enforcement and civil penalty authority.¹⁶ Those procedures generally give the agency’s enforcement staff the discretion to notify persons who may be named in an enforcement proceeding of the nature of the staff’s proposed allegations. Persons who receive such a notice have the option to submit a written statement explaining why, as a matter of law, fact or policy, the staff should not recommend that the agency commence an enforcement action against them. The factual portion of such a submission usually must be sworn to by a person with personal knowledge of the relevant facts.

A Wells-like procedure would be very valuable to the Commission and potential respondents, particularly with respect to the application of new statutory and regulatory provisions to the wholesale energy markets. The Commission’s staff will want to be very careful before recommending that the Commission initiate enforcement proceedings alleging

¹⁴ MBR Order at P 15.

¹⁵ *Id.*

¹⁶ Comments of the Interstate Natural Gas Association of America, Docket No. RM06-3, at 12 (Nov. 17, 2005) (citing 17 C.F.R. § 202.5(c)); 17 C.F.R. Part 11, Appendix A (CFTC Informal Procedure Relating to the Recommendation of Enforcement Proceedings).

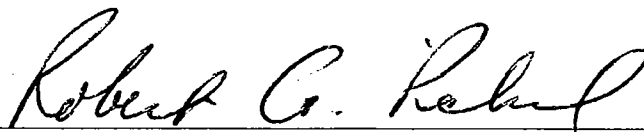
manipulation violations by wholesale market participants who operate in competitive markets in which most transactions are settled financially. Before making such recommendations, the staff should have the option to give potential respondents the opportunity to explain why their conduct, in the context of the facts and applicable law, did not violate the Federal Power Act, Natural Gas Act or the Commission's regulations.

Accordingly, the Commission should publish a separate notice of proposed rulemaking to review the existing regulations for investigations and implement a Wells-type procedure. As part of that proceeding, the Commission should afford interested parties an opportunity to comment on the proposed rule.

III. CONCLUSION

ISDA urges the Commission to state explicitly that the material omission standard in the proposed rule applies only to communications with the Commission and to its delegates as set forth in current Market Behavior Rule 3. In addition, the Commission should adopt a scienter requirement. Lastly, ISDA suggests that the Commission issue a new notice of proposed rulemaking to consider implementing a Wells-type process similar to those used at other agencies prior to initiating any enforcement proceedings.

Respectfully submitted,



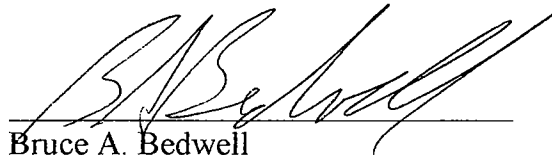
Robert G. Pickel, Executive Director and
Chief Executive Officer
International Swaps and Derivatives Association, Inc.
360 Madison Avenue - 16th Floor
New York, NY 10017
Phone: (212) 901-6000
Fax: (212) 901-6001

Dated: December 5, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 5th day of December, 2005.



Bruce A. Bedwell
McDermott, Will & Emery
600 Thirteenth Street, N.W.
Washington, D.C. 2005-3096
(202) 756-8000