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Manipulation of California energy market gives consumers a jolt

The California Independent System Operator estimates that JPMorgan Chase & Co. may have gamed the sta
power market for $57 million in improper payments over six months in 2010 and 2011. (AFP/Getty Images /
2012)

By Michael Hiltzik
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The next time your electricity bill prompts you to curse your
another target where you should direct JPMorgan Chase & Co., which
has manipulated the California energy market for its own
residents and businesses in the state that could be $100
much more.

That's the accusation leveled by the California Independent System Operator, which
has jurisdiction over 80% of the state's electrical transmission
corporation controlled by the state government, estimates that
gamed the state's power market for $57 million in improper payments over
months in 2010 and 2011.

But that could be just the tip of the iceberg: The
that time frame, according to the ISO. It also says JPM
could have thrown the entire energy market out of whack,
could be incalculable costs on ratepayers.

The Federal Energy Regulatory Commission, the regulator of
markets, has started a formal investigation into Morgan's allegedly manipulative
energy deals in California and with the Midwest ISO, whi
Michigan to Montana.

Forget JPMorgan's publicized multibillion-dollar trading loss in derivatives;
this trade turned a handsome profit, and it came directly out of
hides. The toll may not have amounted to much for
women and children in California. But collectively it's a
the entire state.

What's worse, it shows that we haven't learned anything from Enron's bogus energy
trading, the disclosure of which helped destroy that firm in

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its ☐ð executives ☐ð in ☐ð jail. ☐ð To ☐ð the ☐xploitent ☐ð loopholes was ☐ð in designed ☐ð energy ☐ð to
trading ☐ð rules, ☐ð experts ☐ð say, ☐ð the ☐ð scheme ☐ð allegedly ☐ð perpetrated ☐ð b
Energy ☐ð Corp. ☐ð is ☐ð cut ☐ð from ☐ð the ☐ð same ☐ð cloth ☐ð as ☐ð Enron's ☐ð in
which ☐ð cost ☐ð the ☐ð state's ☐ð ratepayers ☐ð an ☐ð estimated ☐ð $1.4 ☐ð billion ☐
☐ð
"There's ☐ð nothing ☐ð really ☐ð new ☐ð under ☐ð the ☐ð sun," ☐ð says ☐ð Robert ☐ð
Ore., ☐ð energy ☐ð expert ☐ð who ☐ð reviewed ☐ð the ☐ð ISO ☐ð complaint ☐ð at ☐ð m
you're ☐ð paying ☐ð in ☐ð your ☐ð monthly ☐ð bill."
☐ð
Asked ☐ð for ☐ð a ☐ð response ☐ð to ☐ð the ☐ð ISO's ☐ð allegations, ☐ð a ☐ð JPMorgan spokeswoman referred me
to ☐ð a ☐ð court ☐ð brief ☐ð the ☐ð bank ☐ð filed ☐ð last ☐ð week ☐ð stating ☐ð that
misconduct ☐ð and ☐ð pointing ☐ð out ☐ð that ☐ð FERC ☐ð hasn't ☐ð found ☐ð any, ☐ð
inquiry ☐ð is ☐ð still ☐ð at ☐ð an ☐ð early ☐ð stage. ☐ð But ☐ð given ☐ð the ☐ð energy market, this complex
may ☐ð be ☐ð one ☐ð of ☐ð those ☐ð cases ☐ð in ☐ð which ☐ð the ☐ð scandal ☐ð lies
what's ☐ð legal.
☐ð
One ☐ð issue ☐ð raised ☐ð by ☐ð this ☐ð affair ☐ð is ☐ð whether ☐ð government ☐ð reg
tools ☐ð to ☐ð enforce ☐ð trading ☐ð rules. ☐ð FERC's ☐ð investigation ☐ð could ☐ð take years, and its ☐ð ta
maximum ☐ð penalty ☐ð is ☐ð $1 ☐ð million ☐ð per ☐ð day ☐ð of ☐ð violation. ☐ð If ☐
even ☐ð six ☐ð months ☐ð of ☐ð misbehavior, ☐ð the ☐ð $180 million bill would ☐ð be ☐ð a ☐ð pittance ☐
with ☐ð the ☐ð $14 ☐ð billion ☐ð in ☐ð revenue ☐ð collected ☐ð annually ☐ð by ☐ð JPM
banking ☐ð arm, ☐ð which ☐ð houses ☐ð the ☐ð energy ☐ð trading.
☐ð
The ☐ð incentive ☐ð remains ☐ð for ☐ð outfits ☐ð like ☐ð JPMorgan ☐ð to ☐ð stretch ☐
point ☐ð if ☐ð they ☐ð get ☐ð caught, ☐ð the ☐ð cost ☐ð is ☐ð tolerable; ☐ð if ☐ð not, ☐
raises ☐ð again ☐ð the old question ☐ð Can ☐ð Wall ☐ð Street ☐ð be ☐ð trusted? ☐ð And ☐ð
old ☐ð answer: ☐ð no.
☐ð
"You ☐ð set ☐ð up ☐ð these ☐ð rules," ☐ð says ☐ð Carl ☐ð Wood, ☐ð a ☐ð former ☐ð P
who ☐ð served ☐ð during ☐ð the ☐ð California ☐ð power crisis of 2000 "and you have all ☐ð
very ☐ð smart ☐ð people ☐ð figuring out ☐ð how ☐ð to ☐ð game ☐ð them."
☐ð
Indeed, ☐ð there ☐ð are ☐ð signs ☐ð that ☐ð trading ☐ð scams ☐ð are ☐ð rife: ☐ð FERC
Deutsche ☐ð Bank of ☐ð manipulating ☐ð the California ☐ð market ☐ð and ☐ð in ☐ð March ☐ð extracted
$245-million ☐ð settlement ☐ð from Baltimore's ☐ð Constellation ☐ð Energy ☐ð over ☐ð charge
made ☐ð manipulative ☐ð trades ☐ð in ☐ð the ☐ð New ☐ð York ☐ð market. ☐ð (The ☐ð
determination ☐ð is ☐ð "preliminary" ☐ð and ☐ð subject ☐ð to ☐ð further ☐ð investigation
☐ð
These ☐ð are ☐ð trades ☐ð that ☐ð "don't ☐ð create ☐ð jobs ☐ð or ☐ð economic ☐ð valu
director ☐ð of ☐ð the ☐ð energy ☐ð program ☐ð at ☐ð the ☐ð public ☐ð advocacy ☐ð or
☐ð
Hints ☐ð of ☐ð JPMorgan's ☐ð behavior ☐ð leaked ☐ð out ☐ð this ☐ð month, ☐ð when ☐
demand ☐ð unedited ☐ð versions ☐ð of ☐ð emails ☐ð it ☐ð had ☐ð subpoenaed ☐ð from ☐ð t
generally ☐ð treated ☐ð FERC's ☐ð demand ☐ð as ☐ð little ☐ð more ☐ð than ☐ð a ☐ð PR
Morgan. ☐ð
☐ð

But the email dispute is a sideshow. The center ring
allegations of pulation mani These involve an energy trading unit t
2005 as part of a plan to make money via broad range
commodities with rapidly changing prices, including electricity. JP
actually own any plants to provide power to California, but holds contra
generators allowing it to offer their power in trading mar

The California ISO hasn't been very forthcoming with details
misdeeds. Its public filings don't even name the company; FERC's brief
fingered JPMorgan.

The ISO's language describing the scheme is impenetrable to
piece of original filing with FERC, untranslated from the original gibb

"The use of a particular bidding practice, in conjunction with
metered energy adjustment factor to the calculation of marke
offset bid costs, resulted in overpayment of bid cost reco
resources."

ISO refused our request to put that in plain English.
McCullough and other experts, however, we've unwound what
accused of doing in the ISO and FERC filings. Be prep
diabolically simple.

The alleged scheme involves two related wholesale electricity
by the ISO. The day-ahead market, in which power plant owners
to provide power for the California electricity grid in the
market, an auction market through which ISO buys electricity
distribution to homes and businesses.

To give plant owners an incentive to participate in these
cover their costs for starting up and running their plants ev
their bids aren't accepted. This is known as "bid cost
bidders to claim payments of up to twice their real c

In simplest terms, JPMorgan submitted bids in the day-ahead market so
low the firm was certain to be accepted onto ISO's roster
suppliers — in fact, they were negative bids, essentially offering
their electricity. The bidding is overseen by software, not
automated program isn't smart enough to distinguish a real
fake one. (Implausible as it may seem, there are legitimate reasons for a power
generator to submit a negative bid, but they don't apply
that JPMorgan ever intended to make that sale, but the beaut
that they made it eligible to collect bid cost recovery

The next step was for JPMorgan to make sure that IS

electricity, presumably because of the profit from the bid cost recovery
was greater than from actually selling in the energy market. So it priced the
its electricity so high that ISO wouldn't buy it.

The bottom line, the ISO says, is that JPMorgan's traders
electricity via these bids. The scheme, it says, seems to
capture a bid cost recovery payment the bank didn't dese
inflated anyway.

ISO says it first noticed that its auction was being ga in August 2010,
when bid cost recovery claims started creeping above the
million to $7 million a month. By February, the monthly
than half the sum, it turned out, was draining out thr

So in March last year, ISO put through an emergency
to stamp out the practice by immediately revising its bid
granted, and the problem disappeared ... for 10 days.

Then, the ISO found the perpetrators discovered another loophole and started
squeezing that until it screamed for mercy. As a result,
unnecessary costs of $5.3 million over a period of just
new scheme prompted the ISO to seek a second emergency FERC rule change, also
granted.

Through a spokeswoman, Jennifer R. Zuccarelli, JPMorgan disputes
were designed to avoid selling electricity. Its energy trading
stood ready, able and willing to fulfill the bids we ma
observes that bids submitted to the ISO are secret to
therefore its traders have "no way of knowing" whether
its bids. In other words, for all the traders know, they'll have

Other experts, however, say it's not so difficult to place
accepted. McCullough suggests that the questionable bidding may
focused on times of the year and day when electricity demand, and
the risk of having to fill a bid, is low.

He also says that the secret bidding is part of the
were public, they would be subject to more competition; s
a swindle might be uncovered much faster.

What the JPMorgan accusations really underscore is that a
electricity, the basis of FERC's regulatory policies, doesn't exis
vulnerable to anyone who can uncover a loophole — and the rules are so complex
that there are almost certain to be more loopholes than

FERC says it has the legal authority to return the sta

model, in which generators would only get paid for their true cost
plus a reasonable financial return. It also has the authorit
restrictions on JPMorgan or any other market participant it
manipulation, as it did against the Enron (though that company was already
bankrupt). The agency hasn't indicated whether it might take

What should scare the regulators and ratepayers is that there may be m
more scams out there, all driving up consumers' costs. According to California ISO
documents, JPMorgan's scheme got discovered only because the
so much in excessive payments that it became hard to

"JPMorgan got greedy," Slocum says. If their take was "25
instead of 200%, they never would have been caught."