Federal Anti-Market Manipulation Authority

Policing of Electricity and Natural Gas Markets

In the wake of the 2000-2001 Enron scandal that triggered the West Coast Electricity Crisis, Congress required greater transparency in electricity and natural gas markets and empowered the Federal Energy Regulatory Commission (FERC) to go after bad actors who manipulated markets to exploit consumers.

Since 2005, FERC has built a permanent cadre of internal energy experts that continually monitor and investigate anomalous market trends and suspicious behavior. These policemen on the beat have uncovered numerous schemes which to date have assessed over $1.3 billion in civil penalties and recovered illegal profits.

Policing of Energy Futures Markets

In the wake of the 2008 Financial Crisis, Congress empowered the Commodity Futures Trading Commission (CFTC) with the authority and responsibility to pursue market manipulation in financially-settled energy commodity derivatives markets.

Over the last decade, the CFTC has used their anti-fraud and anti-market manipulation authority to prosecute more than 50 actions which have collectively imposed more than $4.5 billion in monetary relief, including penalties, disgorgement and restitution. Some of these actions included illegal activity involving fuel oil products. The Federal Energy Regulatory Commission also uses vital financial market data from the CFTC to more effectively police electricity and natural gas markets.

Gap in Policing of Transportation Fuel Markets

The Federal Trade Commission (FTC) could, like FERC and CFTC, provide better energy market oversight and proactively prevent fraud and manipulation using the identical statutory authority Congress provided the Commission in 2007. However, the FTC currently lacks the market data and dedicated staff of market experts to effectively monitor and detect manipulation of petroleum markets.

Examples of Energy Market Manipulation Violations

- *FERC & Shell Energy North America:* FERC found that Shell trading of physical natural gas at two California trading hubs was intentionally manipulated in order to benefit its derivatives positions connected to the same prices.

- *FERC & Vitol et al:* FERC found that Vitol et al. was selling physical power at a loss for the purpose of benefitting its derivatives positions connected to the same prices.
- *FERC & Barclays:* FERC found that Barclays was making uneconomic physical electricity market trades to benefit its financial derivatives positions connected to the same prices.
- *FERC & Powhatan Energy Fund, LLC et al:* FERC found that Powhatan et al. was making fraudulent wash trades (buying and selling to yourself for no economic risk and no net sale) in order to collect certain electricity market payments.
- *CFTC & Arcadia, et al.* CFTC found that Arcadia used its large physical crude oil position, for which Arcadia had no commercial need, to repeatedly force futures prices up and then back down to benefit Arcadia's own derivatives positions connected to the same prices.

Additional Background

FERC has Successfully Protected Ratepayers

Prior to 2005, there was very little transparency, oversight, or enforcement in the electricity and natural gas markets overseen by FERC. However, some pre-2005 manipulations, including the particularly egregious schemes perpetrated by Enron, exposed the level of anti-competitive behavior that was likely occurring.

That changed after Congress gave FERC additional authority in the 2005 Energy Policy Act to go after "manipulative devices or contrivances" in jurisdictional wholesale power and natural gas markets and in jurisdictional transmission and transportation services. Post-2005, FERC slowly began standing-up its new authority to collect data, build staff resources and expertise, conduct investigations, and pursue enforcement actions on a vast array of bad actors in the energy markets it oversees.

This proactive policing has yielded considerable results. FERC has approved 127 settlement agreements and has assessed more than $790 million in civil penalties and ordered more than $521 million in disgorgement from bad actors that inflated prices and harmed energy consumers. In addition, having a policeman on the beat has almost certainly discouraged many other would-be manipulative schemes.

What is Market Manipulation?

Market manipulation can take many complex forms, but every scheme boils down to forcing prices away from the fundamentals of supply and demand to benefit the manipulator's account at the expense of other market participants and downstream price-taking consumers.

Market manipulation frequently involves both a physical and derivatives position (e.g. futures contract) connected in the same commodity market, which are then used together by the manipulator such that anti-competitive actions in one position (e.g. hoarding physical stocks, banging the close) move the price in the desired direction in order for the manipulator to profit in their other connected, but often hidden position.

Manipulations have occurred across a vast array of markets, from interest rates (e.g. LIBOR up until 2012) to precious metals (e.g. silver by Hunt Brothers in 1979-80) to agricultural commodities (e.g. soybeans by Ferruzzi in 1989) to electricity (e.g. Enron 2000). As long as there is the incentive of large financial gains to be made by market manipulation, particularly in opaque markets with little oversight and where the risks of being caught are minimal, no market is immune.

Who Determines What Counts as Manipulation?

Instead of making "manipulation" generally unlawful, the Securities and Exchange Act of 1934 made it illegal to use or employ "any manipulative device or contrivance" against the public interest or to harm investors. This clause was purposefully drafted to be a catch-all to provide the SEC with the flexibility necessary to deal with new manipulative devices as they arose in the future.

Over the subsequent decades, the courts have had no trouble understanding the meaning of this powerful clause, and a robust body of case law has developed that provides clear guidelines of what constitutes market manipulation. Indeed, the Supreme Court has compared that body of law to "a judicial oak which has grown from little more than a legislative acorn."

Congress relied on the availability of this larger body of preexisting law and precedent when it used the same Exchange Act clause in a 2005 statute providing FERC with the authority to police electricity and natural gas markets. Then again in 2007, Congress gave the FTC the authority and responsibility to prohibit market manipulation and reporting of false information made in connection with wholesale purchases or sales of crude oil, gasoline, or petroleum distillates. The powerful clause was made part of the authority of the CFTC in its jurisdictional markets in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Benefits of Transparent Markets

The non-partisan Congressional Research Service found that, "[m]any empirical studies have investigated how changes in price transparency have affected various markets," and "[m]ost of this evidence ... suggests that price transparency leads to lower and more uniform prices, a view consistent with predictions of standard economic theory." Transparency in markets and trading leads to more efficient and accurate price discovery driven by supply and demand fundamentals. Conversely, opaque markets can harbor non-competitive practices and allow outright manipulation.