EL12-103

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

August 26, 2013

The Honorable Elizabeth Warren
The Honorable Edward J. Markey
United States Senate
Washington, D.C. 20510

Dear Senators Warren and Markey:

Thank you for your letter of July 31, 2013 about the Federal Energy Regulatory Commission's (Commission) recent resolution of its investigation of bidding practices utilized by J.P. Morgan Ventures Energy Corporation (JP Morgan) in the California Independent System Operator (CAISO) and Midcontinent Independent System Operator (MISO) electricity markets.

I appreciate the opportunity to address your questions about this important matter. My answers to the specific questions set forth in your letter are as follows:

1) Question: What analysis did FERC conduct to evaluate harms to consumers? Did FERC's analysis take into account the ripple effect of manipulations and indirect costs to authorities and ratepayers? If so, please make that analysis available to our offices. Does the Commission believe that the $125 million in disgorged unjust profits is sufficient to make ratepayers whole?

Answer: JP Morgan's unjust profits were the result of receiving certain specific types of payments (such as Bid Cost Recovery payments) made by CAISO or MISO. The Commission's Office of Enforcement calculated the firm's unjust profits using CAISO and MISO settlement statements, resolving any doubts in favor of greater reimbursement to consumers. In discussions with the Office of Enforcement staff, the Market Monitors for CAISO and MISO confirmed that CAISO and MISO consumers are being fully compensated for all direct and indirect impacts of JP Morgan's manipulative schemes.

JP Morgan will pay $125 million in disgorgement to CAISO and MISO, and will also waive pending claims against CAISO. CAISO has calculated the value of the waived claims to be $262 million. On July 30, CAISO issued a press release in which it stated that as a result of the settlement, "FERC has acted to send every dollar in overcharges back to California ratepayers."

2) Question: Do you believe it to be the case that JP Morgan granted its trading rights to two independent firms during the six-month suspension period to evade FERC's penalties? If so, does FERC consider the six-month suspension to have been an effective penalty? And, if it was not an effective penalty, what other penalties could FERC impose to better deter improper conduct?

2013-00072

Answer: As noted in your question, it appears that JP Morgan has transferred its trading rights with respect to some facilities in Southern California to two independent firms. Because issues related to that transfer and implementation of the suspension of JP Morgan's market-based rates are currently pending before the Commission, I cannot comment on the merits of those issues at this time.

3) **Question: Is the Commission concerned, based on the high and increasing number of recent FERC enforcement actions, about an increase in market manipulation?**

Answer: As noted in your question, the Commission's Office of Enforcement in recent years has investigated a substantial number of entities and individuals for market manipulation. A number of those investigations led the Commission to impose civil penalties through either a settlement or litigation. The substantive conduct at issue in these investigations, however, occurred over a period of several years, going back as far as 2006 (*Barclays*) and 2007 (*Constellation*, *Polidoro*, *Rumford*). Therefore, the fact that these investigations have become public recently does not indicate that market manipulation has become more prevalent in the past few years.

Since Congress gave the Commission new authority in the Energy Policy Act of 2005 (EPAct 2005), the Commission is in a better position to promptly detect, investigate, and seek sanctions against such unlawful conduct. To that end, over the past few years, the Commission's Office of Enforcement also has substantially expanded its investigative and analytical capabilities and has developed extensive new surveillance capacity.

4) **Question**: **Does the Commission believe it has the necessary jurisdiction over related financial markets to make certain that energy consumers are protected? Specifically, what is the status of the Memorandum of Understanding required under the Dodd-Frank Wall Street Reform Act to clarify how FERC and the CFTC plan to address information flow and prevent market manipulators from exploiting gaps in regulatory oversight?**

Answer: The Commission believes it was given broad jurisdiction under EPAct 2005 to protect energy market consumers from any fraud or market manipulation occurring in related financial markets that affects the wholesale natural gas and electric markets subject to the Commission's exclusive jurisdiction. As you know, however, earlier this year, the U.S. Court of Appeals for the District of Columbia Circuit ruled in *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013), that the Commodity Futures Trading Commission's (CFTC) exclusive jurisdiction over futures deprives FERC of authority to bring an action based on manipulation in the futures market, even if the activity affected prices in the physical markets for which FERC has exclusive jurisdiction.

While I am disappointed by the court's holding in *Hunter*, I also read the *Hunter* decision as narrow in scope. Some market participants, however, interpret the decision more broadly to cover not only manipulation in the futures market, but also many additional transactions and products, including those squarely within FERC's jurisdictional markets. Accordingly, I support a legislative fix to eliminate uncertainty on this matter and ensure that FERC has the full authority needed to police manipulation of wholesale physical natural gas and electric markets.

With respect to the Memoranda of Understanding required under Dodd-Frank, discussions between the Commission and the CFTC have not yet produced an agreement. Although the Commission has developed automated algorithmic screens for surveillance purposes, access to additional data from the CFTC would further enhance the Commission's ability to protect consumers against market manipulation. In particular, FERC seeks access to the Large Trader Report provided by the Intercontinental Exchange to the CFTC. The data in this report will help fill a gap in staff's current surveillance regime – i.e., the ability to see the names and positions of parties that have a financial interest in the formation of prices in FERC's jurisdictional markets.

5) **Question: Will the Commission release the full FERC Enforcement Staff Report of JPMorgan's conduct in this case?**

Answer: The JP Morgan investigation had not reached the stage at which an Enforcement staff report would have been drafted. When the Commission issues an order to show cause, it typically attaches to that order a staff report about the alleged unlawful conduct. For example, the Commission attached an Enforcement staff report when it issued an order to show cause concerning Barclays' alleged market manipulation, *Barclays Bank PLC et al*, 141 FERC ¶ 61,084 (2012). The JP Morgan investigation produced a settlement prior to that stage.

At an earlier stage of an investigation, the Commission's Office of Enforcement may send the entity under investigation, a non-public "Wells Notice" that summarizes Enforcement staff's preliminary findings. Such a notice is sent pursuant to 18 C.F.R. § 1b.19 of the Commission's regulations. The Commission does not make such a notice public. As noted above, when an investigation leads the Commission to issue an order to show cause, an accompanying Enforcement staff report typically addresses the alleged unlawful conduct in detail. When an investigation leads to a settlement that the Commission finds to be in the public interest, the settlement typically provides details about the conduct underlying the investigation. The JP Morgan settlement agreement contains stipulated facts about JP Morgan's conduct, and both the settlement agreement and the Commission's Order set forth conclusions reached by Enforcement staff and the Commission.

6) **Question: Why did the Commission decide to take no action against JPMorgan executives who planned and executed market manipulations or who impeded the Commission's investigations? Is the Commission concerned that these executives will continue to engage in illicit activities at other institutions?**

Answer: The Commission is fully prepared to proceed against individuals when litigation, rather than a negotiated resolution, is in the public interest. For example, the Commission is currently preparing to litigate the above-noted *Barclays* case in Federal district court and is pursuing claims and civil penalties not only against Barclays Bank PLC, but also against four individual traders.

In this instance, however, the Commission determined that acceptance of the settlement was in the public interest as it provided a fair and equitable resolution of the investigation. In particular, the settlement: (a) guaranteed full and complete relief to CAISO and MISO ratepayers through the disgorgement of $125 million, along with the assurance that CAISO ratepayers would not be exposed to additional claims from JP Morgan that CAISO calculates have a value of $262 million; (b) ensured that JP Morgan paid a civil penalty of $285 million, which goes to the U.S. Treasury; (c) sent a strong message to market participants about the types of behavior the Commission considers manipulative, through the inclusion of a detailed set of facts to which JP Morgan stipulated; (d) highlighted for market participants the consequences of engaging in manipulative activity; and (e) ensured that the traders who engaged in the manipulative conduct would no longer participate in bidding in FERC-jurisdictional markets while employed by JP Morgan. The Commission concluded that, on balance, acceptance of the settlement containing these substantial, immediate benefits for ratepayers and the public was preferable to jeopardizing those benefits through the considerable delay and uncertainty posed by pursuing actions against individual JP Morgan employees.

It is worth highlighting one aspect of the Settlement Agreement that imposed significant consequences on the individual traders involved in the alleged misconduct and that could not have been accomplished by taking the matter to trial. The Federal Power Act does not give the Commission the authority to ban traders from electricity markets for market manipulation. Nevertheless, in the Settlement Agreement, JP Morgan has assured the Commission that the traders who engaged in the bidding strategies at issue here will not participate in bidding generation into organized markets, or otherwise engage in power market trading, on behalf of JP Morgan.

7) <u>Question</u>: **Why was JP Morgan permitted to avoid an admission of guilt in this case? Under what circumstances would FERC determine that requiring an admission of guilt is a precondition for settlement?**

<u>Answer</u>: I agree that, in certain circumstances, it is appropriate to insist on an admission of liability. Indeed, within the past year, the Commission has approved a Settlement Agreement with Gila River that included an admission of market manipulation. However, I also believe that neither-admit-nor-deny settlements are a major tool in the arsenal of federal enforcement agencies. In this instance, on balance, the Commission determined that approval of the Settlement Agreement, along with its many immediate, significant benefits to ratepayers, was in the public interest.

It is also worth noting that, unlike many other agencies and prosecutors, the Commission insists that parties stipulate to the relevant facts if they wish to settle a market manipulation claim. In the JP Morgan case, for example, the Commission's Office of Enforcement insisted that the company stipulate to more than 12 pages of detailed facts about its bidding activities. These stipulated facts provide important transparency by enabling other market participants, and the public, to see why Enforcement staff determined that JP Morgan engaged in market manipulation.

The Commission's Penalty Guidelines encourage targets to admit liability by assessing higher civil penalties on targets that do not do so. In this case, one factor the Commission considered in concluding that a civil penalty of $285 million was in the public interest (in a case that also involved $125 million in disgorgement) was that JP Morgan neither admitted nor denied the violations set forth in the agreement.

If you should have any further questions or concerns on this or any other matter, please do not hesitate to contact me or my staff.

Sincerely,

Jon Wellinghoff
Chairman

Document Content(s)

13344903.tif..1-5