Electricity trading probed

By Dale Kasler, The Sacramento Bee
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People stand in the lobby of JPMorgan Chase headquarters, Friday, May 11, 2012, in New York.

It's been a decade since companies like Enron Corp. manipulated California's electricity market to generate billions in excess profits.

Enron went out of business long ago, and California's energy market has been a place of relative calm. Now, however, another big power trader is being investigated for allegedly gaming the state's electricity system.

State officials believe a subsidiary of JPMorgan Chase & Co., the New York investment bank, pulled down an extra $73 million by exploiting a small wrinkle in California's electricity market over several months in 2010 and 2011.

Officials said they've recovered $20 million from the company so far.

For its part, JPMorgan said in court papers earlier this month that no wrongdoing has been found.

Just like a decade ago, the probe involves a company doing business at the California Independent System Operator, an obscure quasi-state agency based in Folsom. The ISO runs the state's transmission grid and oversees last-minute power sales; its computerized trading floor is the nerve center of California's $8 billion-a-year electricity market.

While the Federal Energy Regulatory Commission is investigating on the state's behalf, a prominent energy consultant warns that the ISO's automated market system remains vulnerable to abuse.

"These things are hidden eight levels down in the computer programming," said Robert McCullough of McCullough Research in Portland. "If a computer doesn't catch you, you're not caught."

He said JPMorgan's trading strategy appears to be similar to "Get Shorty," one of the infamous schemes cooked up by Enron to ramp up profits at California's expense during the energy crisis of 2000 and 2001.

ISO officials insist this wasn't a rerun of the energy crisis. They said they've made huge strides in protecting the system and are quick to sniff out problems.

In the latest instance, "it was detected early, it was stopped," said ISO spokeswoman Stephanie McCorkle. "Everything worked as it should."

The questionable trading behavior ended in June 2011, she said.

She added that the ISO's market structure, which was revamped in 2009, is producing "some of the lowest wholesale energy prices seen in the past 15 years in California."

Jim Bushnell, a UC Davis economist who sits on the ISO's market surveillance committee, said it's unfair to equate the latest case with what happened a decade ago.

"The orders of magnitude are much smaller than what we saw in 2001," Bushnell said.

At the same time, Bushnell said, unscrupulous traders always will look for weak points in the ISO's market structure.

"This is taking advantage of a complexity in a little corner of the market," he said, referring to the trading activity being investigated. "There's always some corner that somebody discovers."

McCorkle said the ISO has retrieved $20 million from the company thanks to new powers granted to the agency by the federal government. The fate of the remaining $53 million claimed by the ISO will rest with the federal agency, FERC, which is still investigating.

The investigation began more than a year ago but didn't become public until early July, when FERC sued JPMorgan in U.S. District Court in Washington, D.C. The federal agency accused the company of stonewalling the investigation by refusing to surrender a cluster of emails.

In court papers, JPMorgan said it's "cooperating fully with the investigation" but is acting within its rights to withhold the emails.

The company added that the investigation "remains in the fact-finding stage, and FERC has made no determination that (the company) engaged in misconduct."

FERC's probe goes beyond California. According to court papers, the agency is also investigating whether JPMorgan manipulated markets at the Midwest Independent Transmission System Operator, a multistate agency that's comparable to the California ISO.

In court papers, FERC staff attorney Thomas Olson said he's investigating whether JPMorgan extracted "inflated 'make-whole' payments" from the California and Midwest markets.

Make-whole payments are fees paid to generators for keeping their plants operating at a low boil, on a kind of standby basis.

"Any such improper payments to generators are ultimately borne by the households, businesses and government entities that are the end consumers of electricity," Olson wrote.

JPMorgan doesn't own any power plants. But its Houston subsidiary, JPMorgan Ventures Energy Corp., has contracts with generators to trade their electricity in California and elsewhere.

What allegedly happened is complicated. McCullough, the consultant, said JPMorgan found a way to manipulate two wholesale markets run by the ISO – the "day-ahead" market, in which power is sold for future use, and the "real-time" market, reserved for last-minute deals.

In the day-ahead market, he said, JPMorgan priced its power cheaply – so cheaply that its bid was sure to be accepted. In the real-time market, he said, the company priced the power more expensively – so it was certain the market would buy little if any electricity.

Because its bids in the day-ahead market were accepted, McCullough said, the company ensured it would collect substantial payments – the "make-whole" fees – for running the plants at minimal output.

The fees are an incentive to generators to keep their power plants humming and ready to ramp up production at a moment's notice.

The ISO, in a filing this week with the federal agency, says JPMorgan's alleged scheme twisted that concept out of whack, creating an "inequitable windfall."

Through its bidding, the company collected fees "that were far more than was necessary in order to ensure adequate service," the ISO's lawyers wrote.