

News

Energy crisis case may set new rules; FRONT PAGE; Defining criminal conduct is at stake.

Pamela A. MacLean/Staff reporter

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In the aftermath of California's energy crisis, Reliant Energy Services Inc. gained the dubious distinction in 2004 of becoming the first company in the 70-year history of the commodity price manipulation law to be charged criminally.

Now the case—on appeal before it even goes to trial—has the potential to help define when brokering an array of commodities crosses the line into criminal conduct, and to make price manipulation a more viable tool for prosecutors.

"All eyes are on the appeals process," said William Goodman, trial attorney for Reliant Energy with San Francisco's Topel & Goodman.

The complexities of electric power trading and the then-new code of behavior rules in the California's deregulated power market prompted Reliant to insist that its conduct—alleged withholding of electricity—was part of the rough-and-tumble of competitive markets, not criminal conduct.

Three days before the October 2005 trial date, the government appealed a decision by U.S. District Judge Vaughn Walker to exclude from jurors' view the state's Market Monitoring and Information Protocol (MMIP), which is basically a civil code of conduct for power trading. Briefing in the appeal to the 9th U.S. Circuit Court of Appeals just concluded and the matter is expected to be argued later this year.

Walker reasoned that introducing the MMIP would bootstrap potential civil violations into a claim of proof of criminal misconduct, U.S. v. Reliant Energy Services Inc. , No. CR04-0125VRW. Reliant resolved federal civil claims earlier by paying \$13.8 million back to California for allegedly illegal plant shutdowns in June 2000.

But the MMIP, as evidence of what is considered legitimate behavior, is critical to showing Reliant's "intent to create an artificial price," and a motive to conceal the conduct from regulators, argued Assistant U.S. Attorney Haywood Gilliam. Without the use of the MMIP rules, the government is left with "simply a difference of opinion between experts," Gilliam said. "It is depriving the government of

extremely important evidence."

To prove price manipulation, the government must show Reliant had the ability to influence prices, that artificial prices existed and that Reliant intentionally caused it, according to the government's brief.

The case is significant not only in California, where less transparent pricing rules are under consideration, but also in other states with similar problems, including Texas, according to **Robert McCullough** of McCullough Research in Portland, Ore., an expert on energy regulation who has investigated market gaming for Oregon and California lawmakers.

"I am not sure it is even possible to identify [trading] loopholes beforehand, let alone plug them," he said. "Simply put, would you shop at a supermarket where only insiders can check the receipts?"

California State Senator Joe Dunn, a Democrat, said the criminal conduct by a number of market participants "was a sideshow to the real problem that has not been fixed yet and it can't be fixed by plugging the deregulation scheme."

Dunn, who investigated price gouging in the 2000-2001 energy crisis, supports regulatory controls. Nothing has changed since then, and the electricity players have learned from the crisis: "Don't steal too much money too fast or people will notice," he said. "What you are seeing now is an evolution of behavior...to a legally sanctioned cartel," he said. Now, federal regulations allow the public exchange of information by companies about power demand predictions and supply. Those would have been antitrust violations prior to deregulation, he said.

On June 19, 2000, Reliant Energy Services, owner of five electric generating plants in California, faced multimillion-dollar losses because it had bet high on trading orders on a day the bottom dropped out of the electric market. Houston trader Lisa Flowers; Jackie Thomas, vice president of power trading; Reginald Howard II, a director; and Kevin Frankeny, a manager, are accused of conspiring to turn off four of Reliant's five power plants in California for two days to run up the price of electricity by creating the false appearance of a shortage.

Flowers is heard on a taped conversation on June 23, 2000, with another trader saying, "Yeah, we literally shut everything off but Ormond [Beach power plant]." Asked if the market discovered the closures, Flowers responds, "No. God no."

The alleged scheme allowed them to get out from under the bad market play and instead make \$32 million in alleged overcharges, according to the indictment. The indictment charges the company and the four employees with conspiracy, wire fraud and commodities manipulation.

"We believe we were playing by the rules," said Goodman. "Now with the benefit of 20-20 hindsight, they are saying the rules were different at the time the transactions occurred."

Deregulation rules were producing similar interpretations leading up to the state's energy crisis. In July 1999, Enron lawyers at LeBoeuf, Lamb, Greene & MacRae in New York opined in a memo for Enron on the legality of a trading practice later dubbed a "Ricochet" agreement. "The contemplated transaction, though questionable on business, political and social grounds, does not appear to be prohibited under current law," the six-page LeBoeuf memo states. The memo became public in a Federal Energy Regulatory Commission investigation.

Although Reliant Energy Services is the only company criminally charged, others have agreed to civil settlements. California Attorney General Bill Lockyer has negotiated \$5.3 billion in repayments from 13 companies, including \$450 million from Reliant. Asked why the state didn't pursue criminal charges, Lockyer spokesman Tom Dresslar said, "Our focus from the beginning was to wrench as much economic justice out of these companies for California consumers and businesses. So we've let the feds do their thing on the criminal side."

Reliant's aggressive stance leading up to the criminal case may have hurt it in the long run. In the April 8, 2004, announcement of the criminal indictment, the government pointed out, "Faced with evidence of widespread fraud within the company, Reliant chose to be uncooperative during the federal investigation."

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