Oil and electricity: A compare-and-contrast tale of 2 regulators

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An obscure federal regulator of electricity markets has emerged as a tough cop on the beat, taking on Wall Street banks and big energy firms alike for market manipulation. That aggressive approach stands out when it's compared with that of the regulator in charge of looking for manipulation in the oil and gasoline markets.

Whether manipulation accounts for volatile oil and gasoline prices in recent years is a hotly debated topic since prices began their steep climb in late 2005. Last year's West Coast price spikes amid ample supplies added to the urgency in determining whether excessive financial speculation is driving price volatility.

In 2005, Congress gave new anti-manipulation powers to the Federal Energy Regulatory Commission, the federal regulator of electricity markets. In 2007, lawmakers extended them to the Federal Trade Commission, which protects consumers from the manipulation of gas and oil prices.

To the ire of industry critics and the senator who authored the legislation that gave the new powers to both agencies, only the FERC has used those powers aggressively.

"The whole reason we gave the FTC this authority is because we believe these kinds of things that were happening in energy markets were not isolated to one type of energy, but were being perpetrated in other areas, particularly with oil," said Sen. Maria Cantwell, D-Wash. "The FERC is doing its job in unearthing these things, and the FTC just seems to be asleep at the switch."

In 2005, Cantwell and Congress gave the FERC legal language that changed the tough enforcement threshold from having to show that a company had a "specific intent" to manipulate the market to simply showing that a company had engaged in "reckless conduct." In 2007, when energy security legislation was passed, the FTC got the same "reckless conduct" standard.

The backdrop was the soaring oil and pump prices, which peaked in 2008 but remain high. It took the FTC until August 2009 to adopt, and November 2009 to implement, rules pertaining to the new authority.

The FTC didn't make its person in charge of looking into oil and gasoline financial-market manipulation available for an interview, nor did it initially provide numbers on complaints or enforcement. Twice-yearly FTC filings to Congress, which McClatchy Newspapers reviewed, show that the commission has received 28 complaints of oil and gasoline market manipulation since January 2010. A spokesman confirmed for McClatchy that no enforcement cases regarding market manipulation have been brought since the agency was given the new powers.

In a statement to McClatchy, the FTC said it "has found nothing to indicate a possible violation, although ... one complaint remains under review." As to whether it was looking across platforms where oil is traded, the agency statement said, "We simply are not in a position to provide information that would confirm or contradict whatever the public might believe."

Since getting the same language from Congress in 2005, the FERC has announced 72 settlements with industry, many relating to market manipulation probes. Through late January, the revamped agency had levied penalties that exceeded $308 million and secured repayment of more than $158 million in profits that the regulator charged were ill-gotten.

The FERC received its market manipulation powers, and a broader mission under the law, after energy trading giant Enron collapsed in 2001, early in the administration of President George W. Bush.

"Probably equally important, or even more so, they put some teeth in the law, because they actually gave us enough penalty authority to make it hurt if somebody does something wrong," FERC Chairman Jon Wellinghoff said during an interview at the agency's headquarters.

The agency that earlier had denied that Enron had engaged in manipulation was forced to completely revamp its approach to enforcement.

"We had nowhere near the level of personnel and expertise. I think we had like 10 or 15 people total doing enforcement during Enron. Now we have 200. So that has changed radically," Wellinghoff said. "I'm not sure that the actual people and traders have changed that much. We're still seeing people who are trying to engage in things that appear to be similar to what Enron did, but I think because we are here, they are only able to do it on a much smaller scale, and we're catching them."

Importantly, the FERC and the FTC were empowered and encouraged to look at the interplay between the physical markets where electricity or energy products are delivered and the futures market, where contracts for future delivery of each are traded heavily. These futures markets have come to be dominated by Wall Street and the financial sector over the last 15 years.

The FERC has aggressively gone after Wall Street, while the FTC appears reticent.

"It's a bit ironic that we've seen such divergence in the two markets," said Robert McCullough, an energy researcher whose work was instrumental in proving that Enron traders had manipulated electricity markets and who thinks that the same thing is happening in oil.

Critics argue that the FTC has failed to make policing markets a priority.

"They are really not hands-on in this area. The day-to-day watching of it is not part of its mandate. I don't believe it is anyone's," said David Frenk, the director of research for the watchdog group Better Markets. "The word naive is too strong, but they (the FTC) aren't about to blow a whistle."

In contrast, the FERC is locked in legal battle with the deep-pocketed Wall Street bank JPMorgan Chase, accusing it of failing to provide accurate information and omitting material information on electricity trading to regulators and ordering it to the sidelines of such trading for six months. From April 1 through October, the bank's electricity-trading arm may sell energy only at cost and not for the price the market will bear.

On Jan. 22, the FERC slapped a $1.5 million fine on Germany's giant Deutsche Bank for entering into money-losing transactions in the market for physical delivery of electricity that masked the fact that the bank was gaining from the losses because of a position it had taken in the lightly regulated derivatives market, where there's limited review by regulators.

Although the penalty isn't large by banking standards, the action was significant because it highlighted a behavior that Cantwell and many critics of Wall Street think is happening in oil markets. The Deutsche Bank case -- along with a similar ongoing one that involves British bank Barclays -- shows that the FERC is willing to look at transactions across the several financial platforms on which electricity delivery is traded.

That's exactly the kind of deep look that critics complain isn't happening with crude oil, which is refined into gasoline.

"You can't find what you are not looking for," said a congressional aide who's involved in energy legislation, speaking only on the condition of anonymity in order to talk freely about efforts to curb excessive financial speculation in energy markets.

Unlike the FERC, which is a market regulator, the FTC is a law enforcement agency that's charged with protecting consumers. It's historically looked for collusion among refiners or gas station owners. One challenge for both agencies under the new anti-manipulation powers is that they must work with a third agency, the Commodity Futures Trading Commission, which also got the same market-manipulation authority from Congress.

The CFTC's mission is policing the trading of contracts for future delivery of oil and natural gas, which is dominated by financial firms, most of whom never will take delivery of the products. The FERC has yet to reach agreement with the commodities regulator on information sharing, and it was dealt a setback March 15 when a federal court ruled that it had overstepped into the domain of the commodities regulator when it punished a natural-gas trader.

Here's why that decision matters. Historically, about 70 percent of the players in energy and commodities markets were end users of oil and 30 percent were financial speculators. Today those numbers have flipped, and financial speculators trade oil in the futures market and in mostly unregulated "dark markets" where huge two-way bets on oil prices are made between parties in so-called over-the-counter trading.

Unlike the FERC, the FTC has put an information-sharing agreement in place with the regulator of commodities trading, and it touted in its most recent filing to Congress that it's now sharing information.

However, that agreement has been far from effective, according to Bart Chilton, a commissioner on the CFTC.

"With market manipulation, I've been disappointed in the coordination and cooperation with the FTC," said Chilton, adding that "we never hear from them."

Unlike the FERC, the FTC apparently doesn't collect real-time information from wholesale markets, and there's no indication that it's built a database from which it can look across market platforms.

In the early 2000s, when the FERC lacked the specific authority to go after market manipulation and didn't have real-time information, it could only seek to ensure that electricity rates were "reasonable and just." It never punished Enron or its traders.

Further, the agency's enforcement division didn't stand alone. Today it does, and there's also an analytics division, home to what the chairman refers to as his "geeks and wonks," who search for anomalies in the trading of electricity contracts.

Pre-revamp, the FERC could levy fines of up to $10,000 a day. Now it may fine companies up to $1 million a day, something it did in a case that was settled last March for $245 million against Baltimore-based Constellation Energy.

"Those kinds of settlement awards are sufficient to deter actors from continuing to engage in activities that are going to harm consumers in the market," Chairman Wellinghoff said.