

March 12, 2012

## FERC and Constellation Energy Commodities Group Settle Investigation

*A \$135 million civil penalty is issued, along with \$110 million in disgorgement of unjust profits, to resolve investigation into alleged electric energy market manipulation.*

On March 9, the Federal Energy Regulatory Commission (FERC or Commission) approved a Stipulation and Consent Agreement (Settlement) between FERC's Office of Enforcement (OE) and Constellation Energy Commodities Group (CCG).<sup>1</sup> As set forth in the Settlement, CCG has agreed to pay a civil penalty of \$135 million and to disgorge profits of \$110 million, plus interest, to resolve an ongoing investigation into allegations that CCG violated FERC's prohibition of electric energy market manipulation. Additionally, CCG agreed that four of its employees at issue in the investigation would not hold any position involving physical or financial energy trading at CCG or any successor company at any time in the future.

### Background

FERC's order stems from an investigation starting in January 2008. OE's investigation focused on CCG's physical power trading in and around the New York Independent System Operator's (NYISO) control area. After commencing that investigation, OE formed the view that CCG was engaging in virtual trading in the NYISO that was unprofitable.

Additionally, on February 19, 2009, the NYISO Department of Market Monitoring and Performance informed OE that it had decided to apply mitigation measures against CCG related to its virtual bidding behavior in the NYISO because the Market Monitor believed that CCG's virtual load trading in NYISO Zone A had contributed to a divergence of locational-based marginal prices between the day-ahead and real-time markets. Based on such information, OE opened another investigation to determine whether CCG engaged in trading in the NYISO virtual market to move day-ahead prices in a direction that would benefit its financial contract for differences positions.

OE's investigation looked into certain CCG trading activities in virtual trading in NYISO and ISO-New England (ISO-NE); physical day-ahead scheduling between the NYISO and ISO-NE, PJM Interconnection (PJM), and Ontario Independent Electric System Operator; and contract for differences positions in the NYISO and ISO-NE. OE focused on trading activity by certain traders between September 2007 and December 2008. Specifically, OE focused on two traders, a supervisor of those two traders, and the Managing Director of Portfolio Management and Trading.

OE determined that during the relevant time period, CCG held swaps that priced off the average day-ahead prices in the NYISO and ISO-NE, swaps that priced off the real-time price in PJM, financial transmission rights in ISO-NE and PJM, and transmission congestion contracts in the NYISO. OE concluded that the size of the swap positions was substantial. For the period of September 2007 through December 2008, the swap positions entering a month ranged in size from approximately 395 MW/h to approximately 12,274 MW/h in NYISO Zone A, from approximately 125 MW/h to approximately 3,682 MW/h in NYISO Zone G, and from 88 MW/h to 3,350 MW/h in ISO-NE Mass Hub. OE also concluded that over that same time frame, CCG's transmission congestion contract

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1. See *Constellation Energy Commodities Group, Inc.*, 138 FERC ¶ 61,168 (2012).

positions ranged in size from 25 MW/h to 936 MW/h in Zone A and 450 MW/h to 931 MW/h in Zone G.

## Investigation

OE alleged that from September 2007 through December 2008, CCG violated the Commission's prohibition against market manipulation by entering into virtual transactions and day-ahead physical schedules without regard for their profitability, but with the intent of impacting day-ahead prices in the NYISO and ISO-NE to the benefit of certain significant contract for differences positions held by CCG. OE also alleged that as part of this scheme, CCG combined the use of virtual transactions with day-ahead physical schedules to impact day-ahead prices in NYISO and ISO-NE to benefit the contract for differences positions that priced off a component of those impacted day-ahead prices.

OE further alleged that CCG's virtual transactions and day-ahead physical schedules were often large in volume and were scheduled with regularity. For example, OE concluded that in on-peak Zone A during the relevant time period, CCG's virtual trading represented between approximately 24 and 79% of all virtual activity in the Zone when CCG placed a trade. OE also concluded that in approximately half of the on-peak Zone A months, CCG bid virtually in 100% of available hours and only three times did its activity drop below 60% of available hours.

Based on the investigation, OE asserted that (i) CCG's virtual and physical trading activities constituted a fraudulent device, scheme, or artifice and that CCG engaged in a course of business that operated as a fraud upon the NYISO and ISO-NE markets; (ii) CCG intended to manipulate the NYISO and ISO-NE day-ahead markets for the benefit of its contract for differences positions during the relevant time period; and (iii) CCG's manipulative scheme was in connection with transactions subject to FERC's jurisdiction.

OE also asserted that CCG violated the Commission's regulations requiring sellers such as CCG to "provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with . . . Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercises due diligence to prevent such occurrences." Such a violation was deemed to have occurred because, according to OE, CCG provided inaccurate and misleading information to the NYISO by denying that its virtual transactions were related to its contract for differences positions and instead telling the NYISO that the transactions were independent of such positions and were entered into based on market fundamentals.

## Settlement

In addition to the civil penalty and disgorgement of profits, CCG and any successor company agreed to (i) retain communications by its traders, including instant messages, emails, and telephone calls, for a period of no less than five years and to regularly monitor those communications for irregularities or illegalities; and (ii) submit semiannual compliance monitoring reports to OE for two years following the effective date of the Settlement. Further, the two traders subject to OE's focus, their supervisor, and the Managing Director of Portfolio Management and Trading received a ban from holding any position involving physical or financial energy trading at either CCG or a successor company.

In crafting the penalty, OE alleged that (i) CCG's conduct was serious and was committed willfully and intentionally; (ii) CCG's conduct was committed through the participation or oversight of CCG's Managing Director of Portfolio Management and Trading; (iii) the conduct involved more than 100,000 MW/h of electricity and continued for more than 250 days; (iv) CCG's compliance program was not effective at the time; and (v) CCG's actions caused harm and impacted the day-ahead price in FERC's jurisdictional markets.

Following the public release of the Settlement, a Constellation official stated that "Constellation has resolved the FERC investigation. We are putting it behind us and moving forward with our merger with Exelon."<sup>2</sup> The

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2. *Exelon Corp.*, 138 FERC ¶ 61,167 (2012).

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Constellation official also noted that “[w]e believe it is in the interest of all parties to settle this case and avoid expensive, protracted litigation.”

## Contacts

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