Morgan Stanley fine upheld in electricity price-fixing scam

A. Woodson
18 October 2012

A Federal District Court judge in Manhattan has upheld a $4.8 million fine against Morgan Stanley for creating a complex derivatives deal between the utility KeySpan Corporation and its nominal competitor, Astoria Generating Company, enabling KeySpan to illegally profit by maintaining some of the highest electricity rates in the country.

In his August 8 ruling, Judge William Pauley III expressed "misgivings" about the paltry fine and absence of any admission of culpability by Morgan Stanley in the settlement proposed by the Department of Justice's (DOJ's) Antitrust Division.

The DOJ states in its complaint that Morgan Stanley had revenues of $31.6 billion in 2010. Its rate of profit that year was a robust 12.2 percent. Not only was the fine proposed by the DOJ minimal in light of the investment bank's overall earnings, it amounts to less than one quarter of the $21.6 million windfall the bank pocketed from the illegal deal, which ran from 2006 to 2009.

In announcing his decision, Judge Pauley stated the obvious: "There is a risk that a large financial services firm like Morgan Stanley could view such a modest penalty as merely the cost of doing business." He nonetheless accepted a settlement that disproved the adage that "crime doesn't pay."

In 2010, the DOJ fined KeySpan $12 million for its role in the same antitrust violation. Again this fine was less than 25 percent of the $49 million in illicit gains made by KeySpan. And again the settlement included no admission of wrongdoing on the part of the company.

According to government estimates, the monopolistic practice engaged in by Morgan Stanley and KeySpan cost electric power consumers in the state of New York approximately $300 million in higher electricity bills.

The Public Service Commission of the State of New York (NYPSC) and the AARP filed papers opposing the settlement. They condemned the DOJ deal for making the financial penalty too low to deter Morgan Stanley and others from committing the same kind of fraud in the future and for giving the money collected in the fines to the Treasury Department instead of returning it to electricity customers in New York, who were forced to pay the higher rates generated by the deal.

In 1998, New York State deregulated its energy industry. This resulted in Con Edison, which was the regulated public utility monopoly, being broken up and much of its power-generating capacity sold off. Thousands of Con Ed workers were laid off in the process, and today the giant utility is mostly a distribution company.

As the DOJ complaint recounts, at the time of the New York City blackout of 2003 and through 2005, the New York City energy market was dominated by KeySpan, whose total capacity could be sold at its highest price rate, which is called its "bid cap."

At the end of 2005, KeySpan faced the dilemma of an additional 1,000 megawatts of power generation coming on line when a competitor, Astoria Generating Company Acquisitions, owned by Reliant Energy, began operations.

The DOJ complaint describes how Morgan Stanley and KeySpan discussed buying Astoria's generating assets from Reliant Energy, Inc. However, KeySpan concluded such a purchase would place it in violation of anti-trust laws.

The complaint recounts: "Instead of purchasing the Astoria assets, KeySpan decided to purchase a financial interest in substantially all of Astoria's capacity. KeySpan would pay Astoria's owner a fixed revenue

© World Socialist Web Site

stream in return for the revenues generated from Astoria's capacity sales in the auctions."

This was the genesis of the derivatives deal by Morgan Stanley in which the bank agreed with KeySpan that if the price of electricity fell below $7.57 per kilowatt month, Morgan Stanley would pay KeySpan the difference.

At the same time, Morgan Stanley concluded a deal with Astoria that if Astoria were paid more than $7.07 for a kilowatt month of electricity, it would pay the excess to Morgan Stanley. This enabled KeySpan to bid at its highest "bid cap" rate without losing revenue to the lower bid from Astoria because Morgan Stanley would use some of the excess Astoria cash to pay KeySpan, while raking in $21 million for itself. The net result was to relieve the larger firm of any incentive to bid competitively.

Financial firms like Morgan Stanley and Goldman Sachs have played an increasing role in the deregulated energy markets. The need for capital in a capital-intensive industry, energy trading and hedging against demand-and-supply fluctuations have opened the door to finance capital to enter this field in a big way.

This, in turn, increases the pressure for mergers and acquisitions and intensifies the need for more trading and hedging against market uncertainties. This requires increased capital backing for every company in the industry, with the ones having the best connections to the banks having the best chance of surviving and winning the competition to become the new monopoly in the industry.

Deregulation of the power industry was promoted with a promise that as stodgy, inefficient, regulated monopolies were broken up, and the market was opened up to smaller, more efficient competitors, there would be more supply and lower prices in accord with the laws of the free market.

The real economics of deregulation, which has been characterized by price-gouging and financial scams, is that it sets off a scramble for corporations to gain market share and profitability in a frenzied competition that must ultimately lead to re-monopolization of the industry at a higher, more powerful and vicious level.

While there were 100 large utilities in the United States in 1992, today there are 53, and this consolidation is expected to continue. This intense competition is waged in large part by means of shedding workers and slashing labor costs, as evidenced in last July's lockout of 8,500 Con Ed workers. The contract imposed by the company and the union scrapped pensions, raised co-pays on medical insurance and cleared the way for the greater use of contract labor.

Two decades of deregulation of the energy industry have spelled a relentless assault on the jobs and working conditions of the industry's workers as well as on the right of working people to secure and low-cost energy, while the corporate struggle for survival generates profits for Wall Street.

Working people cannot answer these attacks outside of the fight for public ownership of the industry and the banks under workers' control and a workers' government. This is the socialist program fought for by the Socialist Equality Party candidates for president and vice president, Jerry White and Phyllis Scherrer.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact