

COMPETITION & REGULATION UPDATE

MISUSE OF WHOLESALE ELECTRICITY MARKET POWER – US CLASS ACTION PROCEEDS

An anti-trust class action in the United States arising from alleged manipulation of electricity markets is proceeding. This paper provides a short summary of the potential implications for the National Electricity Market in Australia.

WHAT HAPPENED IN THE US?

Class Action to proceed

On 1 April 2016, a US District Court allowed a class action to proceed. The action was brought by Merced Irrigations District (**Merced**) against Barclays Bank PLC (**Trader**) for anti-competitive conduct in electricity markets. We set out below the background to the proceeding.

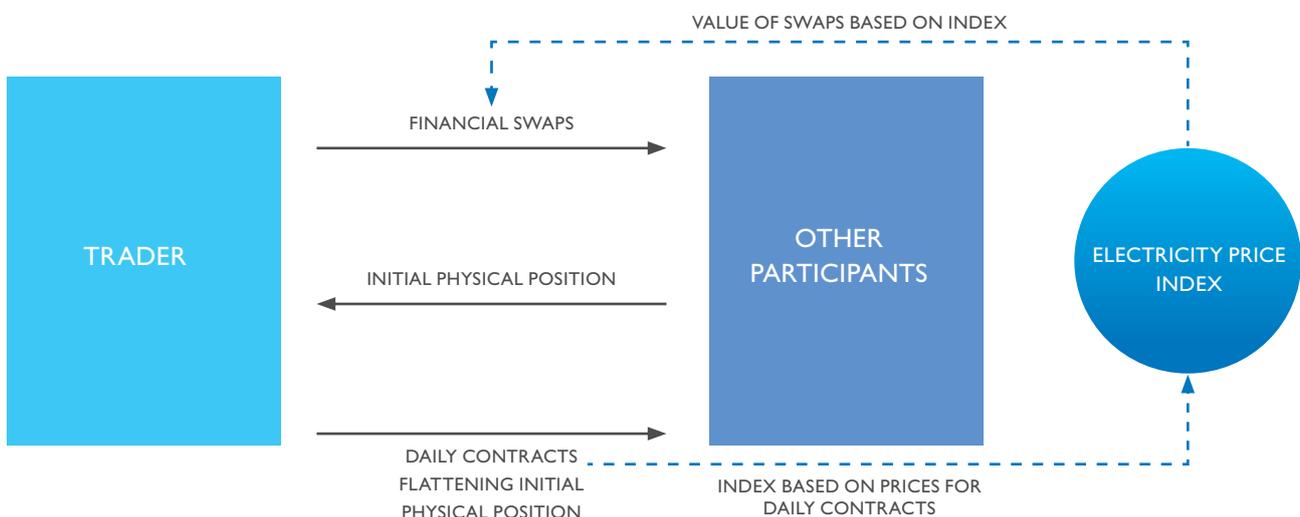
FERC Order

The class action (**Merced case**) follows an order issued by the Federal Energy Regulatory Commission (**FERC**) to the Trader in 2013 in which FERC alleges that the Trader contravened FERC’s anti-manipulation rule (**Anti-Manipulation Rule**) by engaging in a scheme to manipulate the price of day ahead physical

electricity transactions in trading hubs in and around California on 655 days in the period November 2006 to December 2008. FERC concluded that the conduct involved the Trader:

- entering into large volumes of financial swap contracts (**Financial Swaps**) whose value was ultimately determined by the value of an electricity index (**Index**) on a particular day; and
- manipulating that Index by, first, building physical market positions in the opposite direction to the Financial Swaps and, second, ‘flattening’, or reversing, those physical market positions, often at a loss, by trading in the fixed price daily contracts for that day (**Dailies**), which formed the basis for the Index.

A simplified diagrammatic representation of the alleged conduct is set out below.



The Anti-Manipulation Rule prohibits an entity from engaging in conduct including using a fraudulent device, scheme, or artifice, making a material misrepresentation or engaging in any course of business that would operate as a fraud or deceit upon any entity.

FERC defines fraud as including actions for the purpose of impairing, obstructing or defeating a well-functioning market.

FERC alleges that the Trader's conduct was in contravention of the Anti-Manipulation Rule because its Dailies trading was based not on normal supply and demand fundamentals but, rather, on the intent to effect a scheme to manipulate the physical markets in order to benefit the value of its Financial Swaps.

The Trader has filed a motion to dismiss the FERC case and that matter remains before the Courts.

Class action instituted

Following the FERC order, Merced, one of the participants in the market for Dailies, instituted a class action on the bases including that the Trader had breached section 2 of the Sherman Act (**Section 2**). The Trader filed a motion to dismiss. In February 2016, the US District Court concluded that the allegations under Section 2 could proceed on the basis that:

- a monopolisation claim under Section 2 required the plaintiff to allege:
 - the possession of monopoly power in the relevant market; and
 - the wilful acquisition or maintenance of that power.
- the applicant had alleged facts sufficient to state a claim under Section 2 taking into account the allegations as to:
 - the Trader's ability to distort ordinary forces of supply and demand in setting the daily Index prices; and
 - the Trader's wilful maintenance of that power through uneconomical physical trading positions.

Class action allowed to proceed

In March 2016, the Trader moved the Court to reconsider its decision regarding the Section 2 claim arguing that the Court had overlooked controlling law and facts. Specifically, Trader argued that the ability of a court to infer market power from price control applies only where

the defendant can sell for more than the competitive price and did not apply in the present case where the Trader is alleged to have both raised and lowered the Index prices.

On 1 April 2016, the US District Court denied the Trader's motion. In consequence, the case against the Trader under Section 2 of the Sherman Act will proceed.

IMPLICATIONS FOR AUSTRALIA

Although the Merced Case arose in a foreign electricity market, under a foreign law and is yet to go to trial, it could ultimately provide a useful point of reference for future litigation in Australia. For example:

- The Australian Government announced in March 2016 an intention to amend section 46 of the Competition and Consumer Act such that it will prohibit conduct by a corporation with a substantial degree of power in a market which has the purpose or would be likely to have the effect of substantially lessening competition in any market.
- In the Merced Case, the Court referred to the Trader's allegedly intentional efforts to achieve and use monopoly power to manipulate prices. As such, any final judgment is likely to consider issues of market power. Of course, as we have previously observed, demonstrating that a wholesale market participant has market power in Australia faces a number of challenges.
- The new rule 3.8.22A of the National Electricity Rules (prohibiting false or misleading rebidding) will come into effect in July 2016. That provision deems a contravention where a trader does not have a genuine intention to honour a rebid, and expressly allows the Court to consider a pattern of conduct.
- In the Merced Case, the FERC order referred to manipulative intent, the purpose of keeping prices at an artificial level and observed that 'open market transactions send false information into the marketplace if such transactions are undertaken with the intention of creating a false price'. Further, the FERC Order placed considerable store in the Trader's pattern of conduct. As such, any final judgment may well consider those issues further.

MORE INFORMATION

For more information, please contact:



Simon Uthmeyer

Partner

T +61 3 9274 5470

simon.uthmeyer@dlapiper.com



Fleur Gibbons

Partner

T +61 3 9274 5840

fleur.gibbons@dlapiper.com



Alec White

Senior Associate

T +61 3 9274 5144

alec.white@dlapiper.com

Contact your nearest DLA Piper office:

BRISBANE

Level 9, 480 Queen Street
Brisbane QLD 4000
T +61 7 3246 4000
F +61 7 3229 4077
brisbane@dlapiper.com

CANBERRA

Level 3, 55 Wentworth Avenue
Kingston ACT 2604
T +61 2 6201 8787
F +61 2 6230 7848
canberra@dlapiper.com

MELBOURNE

Level 21, 140 William Street
Melbourne VIC 3000
T +61 3 9274 5000
F +61 3 9274 5111
melbourne@dlapiper.com

PERTH

Level 31, Central Park
152–158 St Georges Terrace
Perth WA 6000
T +61 8 6467 6000
F +61 8 6467 6001
perth@dlapiper.com

SYDNEY

Level 22, No. 1 Martin Place
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 4144
sydney@dlapiper.com

www.dlapiper.com

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