Commodity Scams: Barclays, Goldman & JP Morgan Under Fire

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JP Morgan Chase is expected to announce over $600 million in penalties and repayments for allegedly cheating customers in energy markets in California and Michigan. This just after Barclays bank paid out $470 million for manipulating electricity rates. Now Goldman Sachs is under scrutiny for possibly manipulating aluminum prices.

Commodity market scams – from energy to metals – are notoriously hard to track partly because they involve huge players dealing with each other with little outside oversight. For example, consumers are outraged when they get hefty electricity bills but it often take a lot of time for regulators to prove that they deliberately manipulated the markets.

Here's a simple illustration how some of these scams work. Buying or hoarding large quantities of commodities is not illegal but it has the effect of driving prices up while dumping purchases has the opposite effect. Combine the two practices skilfully, it becomes easy to make a quick profit when prices are manipulated to change suddenly. (Say you buy a million shares of something at $10 and then another million at $20. Prices soar as others assume you are on to something, then you dump all of them at $16. Profit $2 million)

Investigators at the U.S. Federal Energy Regulatory Commission (FERC) give the real life example of Ryan Smith, a Barclays trader who exchanged instant messages with another trader on February 8, 2007, about a large position in electricity indices which he dumped at a loss to make a profit with a different investment.

FERC has published excerpts of their chats such as this one:

setcjake: you blow your index load yet?
smittybarcap: not yet. why?
setcjake: watching to see how low the hr's can get
setcjake: its like that battle sceen from Braveheart: hold…hold…unleash hell!
smittybarcap: ha.
setcjake: with no load/low volume, a hvy handed index dump really moves it

"Respondents not only engaged in this manipulative scheme at four trading nodes in the western United States during the Manipulation Months, but that they did so with the intent to commit fraud," FERC officials wrote in a judgement handed down last week, six years after the trading took place.

Smith, together with his colleagues Daniel Brin and Karen Levine, were each fined $1 million, while Scott Connelly, managing director of North American power at Barclays, was fined $15 million.

Barclay denies the charges. “We believe the penalty assessed by the FERC is without basis, and we strongly disagree with the allegations made by FERC against Barclays and its former traders,” Barclays spokesman Marc Hazelton wrote in an email. “We intend to vigorously defend this matter.”

A couple of years later, traders at JP Morgan Chase in Houston came up with a plan to profit out of the rights to sell electricity from several inefficient power plants that they acquired from Bear Stearns, a former Wall Street investment bank. The traders createdeight distinct “schemes” between September 2010 and June 2011 that were “calculated to falsely appear attractive” to government officials in California and Michigan. The buyers paid out $83 million in “excessive” payments, say FERC investigators.

Blythe Masters, the head of global commodities for the bank, “kept close tabs on the California and Michigan power plants” instructing them to inform her of the “many of the bidding schemes under investigation,” say FERC documents seen by the New York Times. Masters then “personally participated in JPMorgan’s efforts to block” government officials “from understanding the reasons behind JPMorgan’s bidding schemes.”

“We intend to vigorously defend the firm and the employees in this matter,” said Kristin Lemkau, a spokeswoman for the JP Morgan Chase told the newspaper back in May. “We strongly dispute that Blythe Masters or any employee lied or acted inappropriately in this matter.”

The bank is now expected to announce a $410 million settlement as well as to give up $200 million in “unpaid claims.” Masters will not face any punishment.

Observers say that the fine amounts to a slap on the wrist. “Going to jail or even being criminally indicted is about as likely for a Wall Street master of the universe as Edward Snowden getting a free ride on Air Force One and joining the Obama family on a Christmas vacation trip to Disney World,” writes Mark Karlin at Truth Out.

The latest fines will push JP Morgan’s fines in the last few years to roughly $16 billion in the last three years, according to financial analyst Josh Rosner of Graham Fisher.

(See below for a useful cheat sheet on some of the major fines, prepared by Matt Taibbi of Rolling Stone)

Sudden changes in electricity prices tend to get noticed through by angry consumers. It’s much easier to get away with subtly raising prices on commodities like aluminum which consumers don’t buy directly. But anybody who buys canned fizzy drinks like Coke or Pepsi pays a fraction of a penny more without realizing it.

Here’s how that works: In 2010 Goldman Sachs, another Wall Street bank, has allegedly worked out a way to manipulate the prices of the metal by buying up the major warehouses where national stocks of the refined metal are stored in Detroit. The bank then deliberately moves the physical metal from one building to the next to delay their sale and push up prices as well as the cost of storing the aluminum. Experts estimate that the hidden cost to the consumer at $5 billion over the last three years.

“It’s a totally artificial cost,” Jorge Vazquez, managing director at Harbor Aluminum Intelligence, a commodities consulting firm, told the New York Times. “It’s a drag on the economy. Everyone pays for it."

"Wall Street is flexing its financial muscle and capitalizing on loosened federal regulations to sway a variety of commodities markets," write reporter David Kocieniewski. "The maneuvering in markets for oil, wheat, cotton, coffee and more have brought billions in profits to investment banks like Goldman, JPMorgan Chase and Morgan Stanley, while forcing consumers to pay more every time they fill up a gas tank, flick on a light switch, open a beer or buy a cellphone."

Last week, the U.S. Commodity Futures Trading Commission (CFTC) announced that it would investigate the practice of commodity warehousing.

Goldman is not the only bank to do this. A mystery buyer recently started buying large quantities of copper till it had as much as half of the copper available in the market stockpiled, causing prices to spike. The buyer was eventually identified: JP Morgan Chase.

Recent JP Morgan Chase Fines and Settlements *(compiled by Rolling Stone)*

• Chase was one of 13 banks asked by the U.S. Federal Reserve and the U.S. Comptroller of the Currency (OCC) to pay up in this year's $9.3 billion robosigning settlement;

• Chase was one of four banks last year to settle for a total of $394 million with the OCC for improper mortgage servicing practices;

• Chase paid $297 million to the U.S. Securities & Exchange Commission (SEC) last November for fraud involving mortgage-backed securities;

• Chase paid $228 million to the SEC for its role in a egregious municipal bond bid-rigging case;

• Chase was fined $153.6 million by the SEC for the "Magnetar" fund case in which the bank allowed a hedge fund to create a "born-to-lose" mortgage portfolio to bet against;

• Chase was convicted in Europe in 2012 along with several other banks for fraudulent sales of derivatives to the city of Milan. A total of about $120 million was seized from Chase and three other banks;

• Chase paid $75 million in cash to the SEC and agreed to forego $647 million in fines in Jefferson County, Alabama where a local politician was bribed into green-lighting a series of deadly swap deals;

• Chase paid a $45 million settlement to the federal government for improperly racking up fees for veterans in mortgage refinancings in 2012;

• Chase paid $25 million to the state of Florida in 2010 for selling unregistered bonds to a state-run municipal money-market fund;

• Chase was ordered by the CFTC to pay $20 million last year for improper segregation of customer funds (this was part of the Lehman investigation). The CFTC also fined Chase $600,000 last year for violating position limits in the cotton markets;

• Chase was reprimanded by the OCC and the Federal Reserve for money-laundering behaviors similar to the infamous HSBC case, and also for regulatory failures and fraud in the London Whale episode. There was a separate U.S. Federal Bureau of Investigation (FBI) inquiry into the London Whale probe in which they allegedly lied to customers and investors about the loss;

- Chase is under investigation by the FBI for allegedly failing to disclose Bernie Madoff's trading activities to authorities.

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