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Latest Chapter in New York Market Manipulation Case: Court OKs Morgan Stanley's $4.8 Million Settlement

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On August 7, 2012, U.S. District Judge William H. Pauley III granted the Department of Justice Antitrust Division's (DOJ) motion for entry of a consent decree requiring Morgan Stanley to disgorge $4.8 million for its role in an allegedly illegal swap agreement that allowed KeySpan Corporation (KeySpan) to manipulate energy prices in the New York City electric generating capacity market (see ***Memorandum & Order***, *U.S. v. Morgan Stanley*, Case No. 1:11-cv-06875 (S.D.N.Y., Aug 7, 2012)). As explained in previous blog entries in ***February 2010*** and ***February 2011***, a financial swap agreement between KeySpan and Morgan Stanley, coupled with Morgan Stanley's hedge agreement with Astoria Generating Company Acquisitions, L.L.C. (Astoria), resulted in KeySpan's acquisition of a financial interest in the capacity of Astoria, its largest competitor. According to the DOJ, this allowed KeySpan to withhold its own generating capacity, resulting in higher electricity prices for New York City consumers. KeySpan and the DOJ reached a settlement concerning this issue in February 2010, with KeySpan agreeing to disgorge $12 million. Comments were filed in response to the DOJ's motion by the Public Service Commission of the State of New York (NYPSC) and AARP. The commenters voiced three main complaints against the consent decree:

1. that the $4.8 million, representing approximately 22% of the bank's net revenues resulting from the arrangements, was inadequate to deter future misconduct,

2. that Morgan Stanley had not admitted any wrongdoing, and

3. that the disgorged money should be returned to New York City ratepayers instead of being remitted to the U.S. Treasury.

In response to these arguments, the Court first explained that its role in reviewing an antitrust consent decree is limited to determining whether the decree is "in the public interest." Judge Pauley further explained that this means the Court's role is not to determine whether the results of the proposed decree will best serve society, but only to ensure that the settlement is reasonable. Although Judge Pauley acknowledged that he shared the commenters' concern that the $4.8 million disgorgement penalty was too lenient, he nevertheless approved the proposed decree. Judge Pauley noted that the DOJ's decision to settle for less than full damages was entitled to judicial deference, particularly given the novelty of the Government's theory and the fact that this case was the DOJ's first attempt to obtain disgorgement from a financial services firm that used derivative agreements to facilitate anticompetitive behavior. The Court further noted that applicable federal antitrust laws did not require an admission of guilt in order for the Court to approve the proposed decree. Additionally, Judge Pauley determined that remittance of the disgorged funds to the U.S. Treasury was appropriate because providing reimbursement to New York City's electricity consumers could circumvent the filed rate doctrine, which bars private actions based on rates previously approved under a federal or state regulatory scheme, and because disgorgement to the U.S. Treasury resulted in less transaction costs, thus serving the public interest.