IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES COMMODITY FUTURES TRADING COMMISSION, Plaintiff, v. ENRON CORP., and HUNTER SHIVELY, Defendants.	CIVIL ACTION NO. H-03-909

ORDER

Pending before the court is defendant Hunter Shively's ("Shively") Motion to Dismiss Count I of the Complaint (Document No. 7) filed by the United States Commodity Futures Trading Commission (the "CFTC") against both Shively and Enron Corporation ("Enron"); Shively's Motion to Sever Count I pursuant to Fed. R. Civ. P. 21 (Document No. 43); and Shively's Motion to Stay Discovery Pursuant to Fed. R. Civ. P. 26(c) Pending Ruling on Motion to Dismiss (Document No. 42). The court will **DENY** Shively's Motion to Dismiss Count I (Document No. 7); **DENY** Shively's Motion to Sever Count I (Document No. 43); and **DENY AS MOOT** Shively's Motion for Stay pending ruling on the Motion to Dismiss (Document No. 42).

I. Background Facts

The CFTC's Complaint, filed on March 12, 2003, brought three causes of action against the defendants pursuant to the Commodity Exchange Act (the "CEA"), 7 U.S.C. §§ 1 *et seq.* (2000), as amended by the Commodity Futures Modernization Act of 2000 (the "CFMA") (Appendix E, Pub. L. No. 106-554, 114 Stat. 2763 (2000)).

The CFTC alleges that on or about July 19, 2001, Enron and Shively, with the aid of at least one additional trader, engaged in a scheme to manipulate the price of natural gas in the Henry Hub next-day gas spot market ("HH Spot Market") traded on EnronOnline

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("EOL"), Enron's electronic trading platform, causing a direct and adverse effect on NYMEX Henry Hub August, 2001 Futures, including causing such prices to become artificial. (Complaint, Document No. 1, ¶¶'s 2, 23 & 25.)

The Henry Hub is comprised of 14 gas pipelines converging near the Gulf Coast of Louisiana. (*Id.* at ¶ 20.) The CFTC alleges that the Henry Hub is one of the "main entry points for Gulf production and is used to direct natural gas to a variety of market areas," and that the "physical configuration of the Henry Hub and the lack of major constraints (congestion) in and out of the hub are factors that support a liquid market there." (*Id.*) The CFTC further alleges that EOL was "the dominant platform for trading in the HH Spot Market in 2001," and that "other HH Spot Market participants routinely looked to EOL and Enron for current HH Spot Market pricing information." (*Id.* at ¶ 21.)

Enron's natural gas trading group was located in Houston, Texas, and was divided into "Desks" such as the Central, East, West, Texas, and NYMEX Henry Hub Futures Desks. (*Id.* at ¶ 18.). Enron traders working these desks were responsible for making a two-way market on EOL, by posting bids and offers that Enron honored as a counterparty. EOL is described as an internet-based trading platform allegedly offering over-the-counter physical commodities and financial products. (*Id.* at ¶ 15.) The CFTC states that EOL functioned such that:

> 1) an Enron trader activated a product on his or her server and made a two-way market for that product by posting a bid and an offer that Enron was willing to honor as a counterparty; 2) EOL displayed that bid and offer over its web site; 3) an EOL customer submitted an order to Enron by either hitting the bid or lifting an offer by clicking on the respective price displayed on-screen; 4) the order went back to the Enron server and was checked for volume, price and credit; and 5) a confirmation was then sent to the Enron trader and to the customer via the internet. (*Id.* at ¶ 16.)

The CFTC states that the HH Spot Market is a "next-day market;" and thus, most traders of gas on EOL "either were flat by the end of the trading day (11 a.m. Central time) or had to be prepared to make or take delivery." (*Id.* at ¶ 21.) Furthermore, the CFTC alleges that EOL accounted for 40% of the average daily volume of trading in the HH Spot Market, such that of

an average of five BcF of HH Spot Market gas traded daily, from March through September 2001, an average of two BcF in that market were traded daily on EOL. (*Id.* at ¶ 21.)

A. The Manipulative Scheme

According to the CFTC, the "manipulative scheme" involved a plan among Enron traders, through a variety of acts and practices, to manipulate the prices in the HH Spot Market on July 19, 2001, by purchasing "an extraordinarily large amount of HH Spot Market gas within a short period of time", with the result that prices became artificial in the HH Spot market and NYMEX August 2001 Henry Hub Futures market. (*Id.* at ¶ 23-5 & ¶ 45.)

The CFTC alleges that Shively went to the East Desk at Enron and bought a very large amount of gas in approximately fifteen minutes causing prices to rise artificially. (*Id.* at ¶ 26 & 28.) Before Shively implemented the scheme, Central Desk traders learned that Shively was going over to the East Desk to "bid up" the HH Spot Market. (*Id.* at ¶ 28.) The head of Enron's NYMEX desk was informed of the plan, and that at some point later in trading, a trader indicated to the Central Desk that the East Desk was "bidding up" the HH Spot Market. (*Id.*) Shortly thereafter, a trader at the Central Desk stated that the East Desk was going to sell the HH Spot Market, and immediately following this alleged pre-arranged "buying spree," Enron began unwinding its HH Spot Market position and prices declined in the HH Spot Market in the first ten minutes. (*Id.* at ¶ 27 & 28.) The CFTC alleges that to ensure the participation of the East Desk trader, Shively agreed to cover any trading losses that trader incurred and did cover such losses by directing that over $80,000.00 be transferred from an administrative trading account Shively controlled to the East Desk trader. (*Id.* at 29 & 30.)

II. Standard of Review

A complaint may be dismissed if it fails "to state a claim upon which relief can be granted." *See* Fed. R. Civ. P. Rule 12(b)(6). However, "[a] complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-6, 78 S.Ct. 99, 102, 2 L.Ed.2d 80 (1957). Furthermore, "the motion to dismiss for failure to state a claim is viewed with disfavor and is rarely granted." *Kaiser Aluminum & Chemical Sales, Inc. v. Avondale Shipyards, Inc.*, 677 F.2d 1045, 1050 (5th Cir.1982) (*citing* Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure Civil § 1357 (1969)).

A court must accept as true, all material allegations in the complaint as well as any reasonable inferences to be drawn from them. *Kaiser*, 677 F.2d at 1050. The court views all well-pleaded facts in the light most favorable to the plaintiff. *McCartney v. First City Bank*, 970 F.2d 45, 47 (5th Cir. 1992). It must be proved to a certainty that the plaintiff can prove no set of facts in support of his claim, but subsumed within this standard is the requirement that the plaintiff state his case with enough clarity to enable a court or opposing party to determine whether or not a claim is alleged. *Elliott v. Foufas*, 867 F.2d 877, 880 (5th Cir. 1989). "While [a] court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations[,]...mere conclusory recitation of the elements of the claims alleged is insufficient to forestall dismissal; a plaintiff must plead each element of its claims with specificity." *Rockbit Industries U.S.A. v. Baker Hughes, Inc.*, 802 F.Supp. 1544, 1547 (S.D. Tex. 1991) (citing cases).

The CFTC's claims in Count I, under sections 6(c), 6(d), and 9(a)(2) of the CEA, 7 U.S.C. §§ 9, 13b, 13(a)(2), need not be pled with the factual specificity required by Fed. R. Civ. P. 9(b). See *Three Crown Ltd. Partnership v. Caxton Corp.*, 817 F.Supp. 1033, 1043, n. 19 (S.D.N.Y. 1993). See also *In re Global Minerals & Metals Corp.*, 1999 WL 1023586, *4 & nn. 50-52 (CFTC Nov. 12, 1999).

III. Analysis

Enron can be held liable for the acts of Shively pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. 2(a)(1)(B)[1] because Shively was allegedly an employee of Enron and his actions on July 19, 2001, were in the course and scope of his employment. Pursuant to the terms of the statute under which the CFTC is suing Shively and Enron, 7 U.S.C. § 9[2], 13(a)(2)[3], 13b[4], causes of action can exist for "manipulating" or "attempting to manipulate" the market price of any commodity in interstate commerce.

Manipulation, undefined in the statute, has been defined by the federal courts in its broad sense as "an intentional exaction of a price determined by forces other than supply and demand." *Frey v. CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991). Nevertheless, the means of manipulation "are limited only by the ingenuity of man." *Cargill Inc., v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971). In *Volkart Brothers, Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962), the Fifth Circuit Court of Appeals noted that 'manipulation' has been construed as "any and every operation or transaction or practice... calculated to produce a price distortion of any kind in any market either in itself or in relation to other markets." *Id.* at 58 (*citing* Mr. Arthur M. Marsh, former President of the New York Cotton Exchange, given in *Cotton Prices, Hearings Before Sub-committee of the Committee on Agriculture and Forestry,* U.S. Senate 70th Cong., 1st Sess., pursuant to Senate Resolution 142, at pp. 201-203.) The court also stated that "[c]ertainly the

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[1]Liability of principal for act of agent. The act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person.

[2] "If the Commission has reason to believe that any person (other than a registered entity) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity..."

[3]"It shall be a Felony...for...Any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to corner or attempt to corner any such commodity..."

[4]"If any person (other than a registered entity) is "manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity..".

term 'manipulate' means more than the charging of what some may consider to be unreasonably high prices. Otherwise there would be grave doubt as to the constitutionality of the statutes." *Volkart*, 311 F.2d at 58. However, in *Volkart*, the court of appeals also concentrated upon the concept of 'intentionality'; in other words, that "there must be a purpose to create prices not responsive to the forces of supply and demand..." *Id.*

The test for manipulation "must largely be a practical one...The aim must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand." *Cargill,* 452 F.2d at 1163. The CFTC alleges that Shively and Enron are guilty of manipulation because they intentionally attempted to and did raise the price of natural gas. To sustain a cause of action for completed price manipulation, the CFTC must allege facts sufficient to establish the following factors:

> (1) that the accused had the ability to influence market prices;
> (2) that they specifically intended to do so;
> (3) that artificial prices existed; and
> (4) that the accused caused the artificial prices. (*In re Cox*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 at 34,061 (CFTC July 15, 1987).

A. Enron Had the Ability to Influence Prices in the HH Spot Market and NYMEX Henry Hub Futures Market

Two of the most discussed forms of market manipulation are the market "squeeze"and the market "corner." *Cargill,* 452 F.2d at 1162. A "corner":

> amounts to nearly a monopoly of a cash commodity, coupled with the ownership of long futures contracts in excess of the amount of that commodity, so that shorts - who because of the monopoly cannot obtain the cash commodity to deliver on their contracts - are forced to offset their contract with the long at a price which he dictates, which of course is as high as he can prudently make it. *Id.* at 1162.

Historically, a 'corner' could be performed solely through the purchase of long contracts in excess of the known deliverable supply, through purchase of the entire cash supply, or through a combination of both. *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 476, 478-79 (7th Cir. 1953)(citing cases). In a "squeeze," there may not be an actual monopoly of the cash commodity itself, but deliverable supplies are low and open interest on the futures market is

"considerably in excess" of the deliverable supplies. *Id.* When analyzing the ability to influence prices under these theories of manipulation, courts look to the defendant's ability to control parts of the market. *See Cargill*, 452 F.2d at 1164-65 (court looks at whether Cargill held a dominant long position in the future and whether there was an insufficient supply of wheat available from sources other than Cargill).

However, courts and administrative decisions point out that proof of manipulation does not always require market control. *In re Soybean Futures Litigation*, 892 F.Supp. 1025, 1047 (N.D. Ill. 1995) (citing *In re Hohenberg Bros.*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, 21477 (CFTC Feb. 18, 1977) ("[a] dominant or controlling position in the market is not a requisite element to either manipulation or attempted manipulation and is not essential to altering successfully the forces of supply and demand."); *In re Henner*, 30 A.D. 1151, 1232-1239 (Agric. Dec. 1971) (control of the relevant cash market is not a necessary element of manipulation, and defendant had attempted to manipulate prices even though he was not in a position to squeeze or corner the market.). "Buying or selling in a manner calculated to produce the maximum effect upon prices, frequently in a concentrated fashion and in relatively large lots" is one form of manipulation, among others. *In re Henner*, 30 A.D. at 1227.

Specifically, the CTFC argues that Shively and Enron had the "ability" to influence market prices because "EOL was the dominant platform for trading in the HH Spot Market in 2001," and accounted for "40% of the average daily volume of trading in that market" (Document No. 10, p. 10; citing Complaint, p. 5, ¶ 21.); because the HH Spot Market participants routinely looked to [EOL] and Enron for current HH Spot Market pricing information" (*Id.*); because defendants "bought a very large amount of gas in the HH Spot Market in a very short period of time, approximately fifteen minutes, in the morning of July 19, 2001, causing prices to rise artificially." (*Id.* at p. 6, ¶ 26.); and, because "[t]he HH Spot Market is a next-day market, thus most traders of this EOL product either were flat by the end

of the trading day (11 a.m. Central time) or had to be prepared to make or take delivery." (*Id.* at p. 5., ¶ 21.)

In light of the relevant law, the court finds that the CFTC's complaint sufficiently alleges facts that Shively and Enron had the 'ability' to force an increase in the price of gas such that an increase did occur through the buying of an "extraordinary" position in gas.

B. Artificial Prices Existed in the HH Spot Market and NYMEX Henry Hub Futures Market

"An artificial price is one that does not reflect the market or economic forces of supply and demand." See *Cox*, ¶ 23,786 at 34,064; *In re Indiana Farm Bureau Coop. Ass'n*, [1982-1984 Transfer Binder] Comm. Fut. Law. Rep. (CCH) ¶ 21,796, 27, 288, n.2. (CFTC Dec. 17, 1982). "Price artificiality traditionally has been studied by relating the price in question to other relevant economic data. Proof of artificiality generally has focused on significant deviations from normal historical futures market patterns and from related contemporaneous markets." *Cox*, ¶ 23,786 at 34,065 (citing *Brannan*, 201 F.2d at 482-83); and *Cargill*, 452 F.2d at 1167-70.). To determine whether a price is artificial,

> one must look at the aggregate forces of supply and demand and search for those factors which...are not a legitimate part of the economic pricing of the commodity....[W]hen a price is effected by a factor which is not legitimate, the resulting price is necessarily artificial. Thus, the focus should not be as much on the ultimate price, as on the nature of the factors causing it. *Indiana Farm Bureau*, ¶ 21,796 at 27,288 n.2.

For example, "[w]henever a buyer on the Exchange intentionally pays more than he has to *for the purpose of causing* the quoted price to be higher than it would otherwise have been..., the *resultant price is an artificial price* not determined by the free forces of supply and demand on the exchange." *In re Henner*, 30 A.D. at 1198 (emphasis added).

In *In re Soybean*, the court noted "that there is no universally accepted measure or test of price artificiality, and that this element can be closely interrelated with the other three elements of a manipulation claim." *In re Soybean Futures Litigation*, 892 F.Supp. 1025, 1057

(N.D. Ill. 1995). Nevertheless, the court was unwilling to find "as a matter of law" that a defendant's conduct or misconduct, alone, was "sufficient proof of price artificiality" to grant summary judgment. *In re Soybean*, 892 F.Supp. at 1057.

The CFTC alleges in its complaint that "[o]n July 19, 2001, artificial prices existed in the HH Spot Market, and in the NYMEX Henry Hub Futures as well." (Complaint, p. 8, ¶ 45) The CFTC describes the time, market, and circumstances surrounding the "price artificiality," alleging that Shively engaged in a fifteen minute "buying spree," raising prices, and eventually unwound Enron's position in the market with a resultant price decline. (Doc. 10, p. 11; citing Complaint, ¶ 26 & 27.) The CFTC also points out that this activity caused prices in the NYMEX Henry Hub Futures Market to become artificial. (Doc 10, p. 12; citing Complaint, ¶ 25.) The CFTC has alleged enough to survive a motion to dismiss.

C. Enron Caused the Artificial Price

This factor does not require proof that Shively was the sole cause of the price artificiality; this factor requires that Shively was the proximate cause. *In re Cox*, ¶ 23,786 at 34,066-67. The CFTC has certainly alleged that Shively caused a rise in price.

The CFTC alleges that Defendants bought a very large amount of natural gas in the HH Spot Market, during which time HH Spot Market prices rose, and then immediately following, Enron began unwinding its HH Spot market position, and prices declined; furthermore, the CFTC states that during this activity, the alleged "manipulative scheme," the NYMEX Henry Hub futures prices became artificial. (Doc. 10, p. 13; citing Complaint, ¶ 23, 25 & 26.)

The court finds the allegations sufficient that Shively and Enron may have been the proximate cause of the price artificiality.

D. Enron Specifically Intended to Manipulate Prices in the HH Spot Market

To prove the intent element of manipulation or attempted manipulation, "it must be proven that the accused acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand..." *Indiana Farm Bureau*, ¶ 21,796 at 27,283. "Since proof of intent will most often be circumstantial in nature, manipulative intent must normally be shown inferentially from the conduct of the accused." *Id.*

The CFTC alleges that Shively's "buying spree"of an extraordinarily large natural gas position, and the unwinding of this position gives rise to an inference that Shively, and hence Enron, intended to manipulate prices. (Doc. 10, p. 14; citing Complalint, ¶ 24, 26 & 27.) However, the CFTC also argues that its 'intent' allegations are bolstered by Shively's enlisting another trader's assistance; Shively's agreement to reimburse this trader for his losses, the fact that other traders knew that Shively went to the East Desk on July 19, to "bid up" the HH Spot Market; the indication by a trader that the East Desk was "bidding up" the market; and finally, the fact that a trader was aware when the East Desk was going to sell its large position. (Doc. 10, p. 14; citing Complaint, ¶ 26, 28, 29 & 30.)

The court finds that the CFTC has alleged sufficient information to draw the inference that Shively acted with the intent to effect price on July 19, 2001.

E. Attempted Manipulation

An attempted manipulation is "simply a manipulation that has not succeeded, that is, the conduct engaged in has failed to create an artificial price." *In re Hohenberg Bros.*, ¶ 20,271 at 21,477. An attempted manipulation "requires only an intent to affect the market price of the commodity and some overt act in furtherance of that intent." *Id.* As the court notes in

Indiana Farm Bureau, the 'specific intent' element for proving 'manipulation' and 'attempted manipulation' is the same. *Id.* (See also *Indiana Farm Bureau*, ¶ 21,796 at 27,283.).

The CFTC does list "attempted manipulation" in the title of Count I: "Manipulation And/Or Attempted Manipulation By Enron And Shively," and it alleges as a violation that "Defendants (1) had the intent to manipulate the HH Spot Market and (2) overtly acted in furtherance of that intent to manipulate the HH Spot Market." (Doc. No. 10, ¶ 48.) As the CFTC argues in its opposition (Document No. 10), Shively and Enron's 'specific intent' and their 'overt acts' to attempt to or to complete a price manipulation would be the same (with only the proviso that with an 'attempt,' an artificial price would not result). Such alternative pleading is sound. The CFTC's claim for attempted manipulation may remain as an alternative claim.

IV. Motion to Sever Count I Pursuant to Fed. R. Civ. P. 21

The court has reviewed the parties' pleadings and finds that the request to Sever County I is **DENIED**.

V. Shively's Motion to Stay Pending Ruling on Motion to Dismiss Count I

As the court has ruled on the Motion to Dismiss, the Motion to Stay is now **DENIED AS MOOT**.

VI. Conclusion

Therefore, it is hereby

ORDERED that Hunter Shively's ("Shively") Motion to Dismiss Count I of the Complaint (Document No. 7) filed by the United States Commodity Futures Trading Commission (the "CFTC") against both Shively and Enron Corporation ("Enron") is **DENIED**;

ORDERED that Shively's Motion to Sever Count I pursuant to Fed. R. Civ. P. 21 (Document No. 43) is **DENIED**; and

ORDERED that Shively's Motion to Stay Discovery Pursuant to Fed. R. Civ. P. 26(c) Pending Ruling on Motion to Dismiss (Document No. 42) is **DENIED AS MOOT**.

SIGNED at Houston, Texas, this 9th day of March, 2004.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE