

UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

\_\_\_\_\_ )  
In the Matter of )  
 )  
JOSEPH B. KNAUTH, JR., ) CFTC Docket No. 04-15  
 )  
Respondent. )  
\_\_\_\_\_ )

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**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 6(c) AND 6(d) OF THE  
COMMODITY EXCHANGE ACT, MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS**

**I.**

The Commodity Futures Trading Commission (“Commission”) has reason to believe that Joseph B. Knauth, Jr. (“Knauth” or “Respondent”) has violated Section 4c(a) of the Commodity Exchange Act, as amended (the “Act”), 7 U.S.C. § 6c(a) (1994).<sup>1</sup> Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Knauth engaged in the violations set forth herein, and to determine whether any order shall be issued imposing remedial sanctions.

**II.**

In anticipation of the institution of an administrative proceeding, the Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Without admitting or denying the findings of fact herein, the Respondent consents to the entry of this Order in full and final settlement of any alleged violations of the Act and regulations thereunder solely as they relate to the activities and conduct described in Section III below, and acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions (“Order”). Respondent consents to the use by the Commission of the findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.<sup>2</sup>

<sup>1</sup> The conduct at issue here predates the December 21, 2000 effective date of the Commodity Futures Modernization Act (“CFMA”).

<sup>2</sup> Respondent does not consent to the use of this Offer or the findings in this Order as the sole basis for any other proceeding brought by the Commission, other than a proceeding brought to enforce the terms of this Order. Respondent does not consent to the use of the Offer or the findings in this Order by any other person or entity in this or any other proceeding. The findings made in this Order are not binding on any other person or entity, including, but not limited to, any person or entity named as a defendant or respondent in any other proceeding.

### III.

#### A. SUMMARY

On at least five occasions between April and June 2000, Knauth, then a power trader at a major energy and power marketing company ("the Company"), executed or offered to enter into and facilitated the execution of non-competitive, prearranged wash sales during his off-exchange trading of electricity (power) contracts. The trades were for the same contract, delivery point, quantity and price, executed with the same counterparty company ("counterparty company") and counterparty trader ("counterparty trader"). The trades were prearranged and designed to produce a wash financial result, with neither party making nor taking, nor intending to make or take, delivery or a *bona fide* position in the market or market risk. Knauth and the counterparty trader agreed to execute a buy and a sell on an electronic trading platform ("Trading Platform"), and then to immediately reverse or offset the first trade by bilaterally executing over the telephone an equal and opposite buy and sell, in violation of Section 4c(a)(A) of the Act, 7 U.S.C. § 6c(a)(A)(1994), which prohibits wash trading. These wash sales caused prices to be recorded on the Trading Platform that were not true and *bona fide*, in violation of Section 4c(a)(B) of the Act, 7 U.S.C. § 6c(a)(B) (1994).<sup>3</sup>

In deciding to accept Respondent's Offer, the Commission considered Respondent's cooperation during the investigation of this matter with Division of Enforcement ("DOE") staff and his agreement to continue to provide substantial further cooperation in ongoing DOE and related investigations.

#### B. RESPONDENT

**Joseph B. Knauth, Jr.**, a resident of Houston, Texas, was employed by the Company from August 1999 through October 2002 as a power trader on the Company's west power trading desk. During the April through June 2000 time period, Knauth traded off-exchange electricity products. Knauth has never been registered with the Commission.

#### C. FACTS

##### 1. The Electronic Trading Platform

Traders at the Company, the counterparty company, and other market participants trade electricity through direct negotiations with counterparty traders (*i.e.*, bilaterally), through voice-brokers, or through electronic trading facilities. During the April through June 2000 time period, the Company and the counterparty company executed electricity trades through, among others, the Trading Platform. At all times relevant hereto, the electronic Trading Platform permitted market participants using the Trading Platform to anonymously post bids and offers for various energy contracts in real time.

<sup>3</sup> Pursuant to the CFMA, Sections 4c(a)(A) - (B) were amended and recodified as 4c(a)(1) - (2), 7 U.S.C. § 6c(a)(1) - (2) (2001).

2. **Knauth Prearranged Roundtrip Trades, That Resulted In Wash Sales and the Reporting of Non-Bona Fide Prices, Utilizing the Trading Platform.**

On at least five occasions between April and June 2000, Knauth executed or offered to enter into and facilitated the execution of non-competitive wash sales with the same counterparty trader. In each instance, Knauth and the counterparty trader prearranged the wash sales over the telephone. They agreed to execute one buy or sell on the electronic Trading Platform and to execute the opposite buy or sell over the telephone. They agreed that the Company would purchase an electricity contract, at a particular price and quantity and for a particular delivery point and delivery terms, from the counterparty company by accepting (or “lifting”) the counterparty company’s supposedly anonymous offer on the Trading Platform. They then agreed to immediately execute via the telephone an equal and opposite sale from the Company back to the counterparty company, at the same price, for the same quantity, for the same delivery point and delivery terms, thus offsetting the initiating trade on the Trading Platform.

For example, on one occasion, the counterparty trader telephoned Knauth and asked “If I put an offer on [the Trading Platform] will you lift me and we’ll trade right out of it?” Knauth responded, “Yeah, I’m sure.” The counterparty trader later confirmed “[s]o let’s see, I sell on [the Trading Platform] and I buy back -- over the counter – for nothing.”

**D. LEGAL DISCUSSION**

**Respondent Engaged In Illegal Wash Sales and Caused Non Bona Fide Prices To Be Recorded on the Trading Platform in Violation of the Act.**

Under Section 4(c)(a)(A) of the Act, it is unlawful for any person to enter into a transaction involving a commodity that may be used for hedging, determining the price basis of a transaction, or delivering a commodity, in interstate commerce, if the transaction is of the character of a “wash sale.” A wash sale is a transaction in which trades are intentionally undertaken for the purpose of giving the appearance that the trades have been executed, without positions being taken in the market or any actual change in the account holder’s market position. See, e.g., In re Piasio, et al., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,686-88 (CFTC Sept. 29, 2000); In re Bear Stearns, et al., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,994 at 37,665 (CFTC January 25, 1991); In re Three Eight Corporation, et al., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,749 at 40,444-45 (CFTC June 16, 1993). In Bear Stearns, ¶ 24,994 at 37,663, the Commission explained:

In a wash sale, for example, a trader gives the appearance of making independent decisions to buy and then sell (or sell and then buy) one or more futures contracts. His actual intention at the time he initiates the transaction, however, is to both buy and sell the contract at the same or a similar price – in other words, to create a financial and position nullity . . . .

See also, Wilson v. CFTC, 322 F3d 555, 559-60 (8<sup>th</sup> Cir. 2003) (wash sales “are considered harmful because they create illusory price movements in the market.”); In re Piasio, ¶ 28,276 at

50,691 (wash sales are “grave” violations, even in the absence of customer harm or appreciable market effect, because “they undermine confidence in the market mechanism that underlies price discovery.”)

Knauth’s five prearranged transactions were noncompetitive trades and were engaged in to produce, and did produce, a financial nullity. Thus, the trades constituted illegal wash sales and Knauth violated Section 4c(a)(A) of the Act. *Id.*; Wilson, 322 F3d at 559-60 (8<sup>th</sup> Cir. 2003); In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,259 at 46,134 (CFTC Feb. 3, 1998).

Section 4c(a)(B) of the Act makes it unlawful to confirm the execution of any commodity transaction “if such transaction is used to cause any price to be reported, registered or recorded which is not a true and bona fide price.” The wash sales prearranged by Knauth caused prices to be recorded on the Trading Platform that were not true and *bona fide*. Accordingly, Knauth violated Section 4c(a)(B) of the Act. In re Gilchrist, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,653 (CFTC Jan. 25, 1991).

#### IV.

### FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that Respondent violated Section 4c(a)(A) and Section 4c(a)(B) of the Act, 7 U.S.C. § 6c(a)(A) and (B) (1994).

#### V.

### OFFER OF SETTLEMENT

Respondent has submitted an Offer of Settlement in which, without admitting or denying the findings herein, he acknowledges service of the Order; admits jurisdiction of the Commission with respect to the matters set forth in this Order and, for any action or proceeding brought or authorized by the Commission based upon violations of or for enforcement of the Order; waives service and filing of a complaint and notice of hearing, a hearing, all post-hearing procedures, judicial review by any court, any objection to the staff’s participation in the Commission’s consideration of the Offer, any claim of Double Jeopardy based on the institution of this proceeding or the entry of any order imposing a civil monetary penalty or other relief, and all claims which he may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000), and Part 148 of the Commission’s Regulations, 17 C.F.R. §§ 148.1 *et seq.* (2003), relating to, or arising from, this action; stipulates that the record basis on which this Order is entered consists solely of this Order, including the findings in this Order; and consents to the Commission’s issuance of this Order. Pursuant to the Offer of Settlement herein, Knauth agrees to entry of an Order, in which the Commission makes findings, including findings that Knauth violated Section 4c(a)(A) and (B) of the Act, and orders that Knauth cease and desist from violating Sections 4c(a)(A) and (B) of the Act; Knauth, beginning on the second Monday after the date of the Order accepting the Offer, be prohibited for one year from trading for his own account, for any account in which he has a direct or indirect interest, or for any other

account, on any registered entity, as that term is defined in Section 1(a)(29) of the Act, 7 U.S.C. § 1a(29), and all registered entities shall refuse Knauth all privileges for that period; Knauth liquidate all futures and options positions held by him or on his behalf, or in which he has any beneficial interest, before the commencement of the denial of his trading privileges; Knauth pay a civil monetary penalty of Twenty-five Thousand Dollars (\$25,000); and Knauth comply with the undertakings set forth in this Order.

Upon consideration, the Commission has determined to accept the Offer.

## VI.

### ORDER

#### Accordingly, IT IS HEREBY ORDERED THAT:

1. Knauth shall cease and desist from violating Section 4c(a)(A) and (B) of the Act, 7 U.S.C. § 6c(a)(A) and (B) (1994);
2. Knauth, beginning on the second Monday after the date of the Order accepting this Offer, shall be prohibited for one year from trading for his own account, for any account in which he has a direct or indirect interest, or for any other account, on any registered entity, as that term is defined in Section 1a(29) of the Act, 7 U.S.C. § 1a(29), and all registered entities shall refuse Knauth all privileges thereon for that period;
3. Knauth shall liquidate all futures and options positions held by him or on his behalf, or in which he has any beneficial interest, before the commencement of the denial of his trading privileges;
4. Knauth shall pay a civil monetary penalty of Twenty-five Thousand Dollars (\$25,000) within ten (10) days of the date of the Order. Knauth shall make payment by electronic funds transfer to the account of the Commission at the United States Treasury, or by certified check or bank cashier's check made payable to the Commodity Futures Trading Commission, and addressed to Dennese Posey, Division of Enforcement, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581 under cover of a letter that identifies Knauth and the name and docket number of this proceeding. Knauth shall simultaneously transmit a copy of the cover letter and of the form of payment to Gregory G. Mocek, Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581; and
5. Knauth shall comply with the following conditions and undertakings, as specified:

**(a) Future Cooperation With the Government**

Respondent shall continue to cooperate fully and expeditiously with the Commission, including the DOE, and all other federal government agencies (hereafter collectively referred to as the "Government") in this proceeding, and in any civil or criminal investigation, civil litigation, criminal litigation or administrative matter related the factual matters discussed herein or related to any activities or conduct by the Company or its officers, agents, or employees. As part of such cooperation, Knauth agrees to:

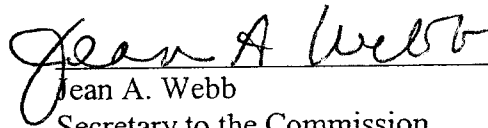
- (1) preserve all records relating to the subject matter of this proceeding or to the Company's trading and generation operating conduct, including but not limited to audio files, e-mails, and trading records;
- (2) respond promptly, completely, and truthfully to any inquiries or requests for information or documents and promptly and completely produce all requested documents;
- (3) provide authentication of documents and other evidentiary material;
- (4) meet with Government attorneys as necessary, regardless of Knauth's residence, at such locations that minimize Commission travel resources; the Commission will reimburse travel expenses as required by law;
- (5) when requested by the Commission, testify completely and truthfully in any civil investigation or civil hearing or other proceeding related to the factual matters discussed herein or related to any activities or conduct by the Company or its officers, agents, or employees; and
- (6) not assert privileges under the Fifth Amendment of the United States Constitution in connection with any testimony he is asked to provide by the Commission in this proceeding, or any other Commission investigation or proceeding, related to the factual matters discussed herein, or related to any activities or conduct by the Company or its officers, agents, or employees.

**(b) Public Statements**

By neither admitting nor denying the findings of fact, Respondent agrees that he shall not take any action or make any public statement denying, directly or indirectly, any findings or conclusions in the Order or creating, or tending to create, the impression that the Order is without factual or legal basis; provided, however, that nothing in this provision shall affect Knauth's (i) testimonial obligations; or (ii) right to take factual or legal positions in other proceedings to which the Commission is not a party. Knauth will

undertake all steps necessary to assure that all of his agents and employees understand and comply with this agreement.

By the Commission.

A handwritten signature in cursive script that reads "Jean A. Webb". The signature is written in black ink and is positioned above a horizontal line.

Jean A. Webb  
Secretary to the Commission  
Commodity Futures Trading Commission

Dated: May 10, 2004