144 FERC ¶ 61,100
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony Clark.

BP America Inc., BP Corporation North America Inc., BP America Production Company, and BP Energy Company — Docket No. IN13-15-000

ORDER TO SHOW CAUSE AND NOTICE OF PROPOSED PENALTY

(Issued August 5, 2013)

1. Pursuant to Rule 209(a)(2) of the Commission's Rules of Practice and Procedure,[1] the Commission's Revised Policy Statement on Enforcement,[2] and the Commission's Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties,[3] the Commission directs the above-captioned companies to show cause why they should not be found to have violated section 1c.1 of the Commission's regulations and section 4A of the Natural Gas Act.[4] BP America Inc., BP Corporation North America Inc., BP America Production Company, and BP Energy Company (collectively "BP" or "Respondent") are alleged to have violated section 1c.1 and section 4A of the NGA by manipulating the next-day, fixed-price gas market at Houston Ship Channel from mid-September 2008 through November 30, 2008. The Commission directs BP to show cause why it should not be assessed a civil penalty in the amount of $28 million and disgorge $800,000 plus interest, or a modification to these amounts as warranted.[5] Pursuant to

[1] 18 C.F.R. § 385.209(a)(2) (2012).

[2] *Enforcement of Statutes, Regulations and Orders*, 123 FERC ¶ 61,156, at P 35-36 (2008).

[3] *Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317, at P 5 (2006).

[4] 18 C.F.R. § 1c.1 (2012); 15 U.S.C. § 717c-1.

[5] *See* 18 C.F.R. § 385.209(b) (2012). We also note that under 15 U.S.C. §717t-1(c), the Commission "shall take into consideration the nature and seriousness of the violation and the efforts to remedy the violation."

Rule 213(a) of the Commission's Rules of Practice and Procedure,[6] the Commission directs BP to file an answer with the Commission within 30 days of the date of this order. Office of Enforcement Staff (OE staff) may reply to that answer within 30 days of the filing of BP's answer.

2. This case presents allegations by OE staff of violations of the Commission's prohibition on market manipulation. These allegations arose out of an investigation conducted by OE staff and are described in the Enforcement Staff Report and Recommendation (OE Staff Report).[7] The OE Staff Report alleges that traders on the "Texas team" of BP's Southeast Gas Trading (SEGT) desk traded physical natural gas at Houston Ship Channel (HSC) to increase the value of BP's financial position at HSC. Specifically, staff alleges that the Texas team traders uneconomically used BP's transportation capacity between Katy and HSC, made repeated early uneconomic sales at HSC, and took steps to increase BP's market concentration at HSC as part of a manipulative scheme. In doing so, staff alleges, the Texas team traders suppressed the HSC *Gas Daily* index with the goal of increasing the value of BP's financial position at HSC from mid-September 2008 through November 2008.

3. Based on the allegations contained in the OE Staff Report, the Commission orders BP to respond to this order as set forth above.[8] This order also is the notice of proposed penalty required pursuant to Commission regulations.[9] In the answer to this order, BP has the option to pay the proposed assessment or contest the order. If BP chooses to contest the order or the proposed assessment, the Commission will issue a further order.[10] If the record is sufficient, the Commission may assess a civil penalty. If a hearing is

[6] 18 C.F.R. § 385.213(a) (2012).

[7] The OE Staff Report is attached to this order. The OE Staff Report describes the background of OE staff's investigation, findings and analysis, and recommended sanctions.

[8] Under 18 C.F.R. § 385.213(c) (2012), BP must file an answer that provides a clear and concise statement regarding any disputed factual issues and any law upon which they rely. BP must also, to the extent practicable, admit or deny, specifically and in detail, each material allegation contained in the OE Staff Report and set forth every defense relied upon. Failure to answer an order to show cause will be treated as a general denial and may be a basis for summary disposition under Rule 217. 18 C.F.R. § 385.213(e)(2) (2012).

[9] *Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317, at P 6-7 (2006).

[10] *Id.*

needed, the Commission will issue a hearing order and indicate whether the Commission will conduct a paper hearing or a hearing before an ALJ. If the Commission chooses to conduct a paper hearing, it will issue an order on the paper hearing record. If the matter is set for hearing before an ALJ, the ALJ will conduct a hearing under Part 385 of the Commission's regulations, and, unless otherwise directed in a hearing order, the ALJ will issue an Initial Decision and determine whether a violation or violations occurred. If a violation is found, the Initial Decision will recommend any appropriate penalty, taking into account factors described in the Policy Statement on Enforcement.[11] The Commission will then consider the Initial Decision of the ALJ and any exceptions filed. If the Commission determines that there is a violation, the Commission will issue an order and may assess any appropriate penalty. In accordance with NGA section 19(a) and Rule 713,[12] BP may request a rehearing no later than 30 days after the issuance of the order assessing the penalty. BP can appeal a final Commission order to a United States Court of Appeals within the appropriate time for review of a Commission order. If the Commission finds a violation and assesses a penalty, if such penalty is not paid within 60 days of assessment, the Commission will institute a collection action in an appropriate United States district court.[13]

4. The Commission authorizes OE staff to disclose information obtained during the course of the investigation as necessary to advance this matter.

The Commission orders:

(A) Within 30 days of the date of this order, Respondent must file an answer in accordance with Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2012), showing cause why Respondent should not be found to have violated 18 C.F.R. § 1c.1 (2012) and 15 U.S.C. § 717t-1(a) (2006) with respect to its trading of physical natural gas at HSC.

(B) Within 30 days of the date of this order, Respondent must file an answer in accordance with Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2012), showing cause why its alleged violation should not warrant the assessment of civil penalties in the amount of $28 million and require it to disgorge $800,000 plus interest, or a modification to that amount as warranted.

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[11] *Id.*

[12] *See* 15 U.S.C. § 717r (2006); 18 C.F.R. § 385.713(d)(1) (2012).

[13] *Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317, at P 5 (2006).

(C) In its answer, Respondent should address any matter, legal, factual or procedural, that it would urge the Commission to consider in this matter.

(D) Within 30 days of the filing of the answer by Respondent, OE staff may file a reply with the Commission.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

FEDERAL ENERGY REGULATORY COMMISSION

BP America Inc., et al.
IN13-15-000

Enforcement Staff Report and Recommendation

Office of Enforcement

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The Office of Enforcement (Enforcement or Staff) reports to the Federal Energy Regulatory Commission (Commission) its findings regarding the conduct of BP America Inc., BP Corporation North America Inc., BP America Production Company, and BP Energy Company (collectively BP) in the next-day, fixed-price natural gas market at Houston Ship Channel (HSC).

I. Executive Summary

Going into September 2008, the Texas team of BP's Southeast Gas Trading (SEGT) desk had a pre-existing Houston Ship Channel (HSC)-Henry Hub spread position that included short index swaps at HSC and long index swaps at Henry Hub. This financial position benefited when the spread between daily physical gas prices at HSC and Henry Hub grew wider. When Hurricane Ike caused HSC gas prices to plummet,[1] the Texas team's September spread position suddenly had the potential to be worth millions of dollars, but only if the daily spread between HSC and Henry Hub remained consistently wide through the end of September.

The evidence shows that recognizing the prospect of substantial profits on their financial position, on or about September 18, 2008, Texas team trader Gradyn Comfort (Comfort), with the cooperation of his two teammates, Nesha Barnhart (Barnhart) and Clayton Luskie (Luskie), began selling next-day, fixed-price gas to suppress gas prices in the HSC market and slow the shrinkage of the beneficial hurricane-created spread. Because the scheme appeared to be working, the Texas team traders extended the manipulation into October 2008 and then into November. They increased their HSC-Henry Hub spread positions and bought more physical gas for these two months at the nearby Katy hub to transport and sell in the daily HSC market to facilitate their efforts to suppress prices at HSC.

Comfort had the motive to initiate this manipulative scheme because he needed to improve his trading performance in 2008. His weak trading results in 2007 had forced him off BP's California desk and after six months on the Texas team, his supervisors relegated him to primarily physical gas trading, instead of the more remunerative financial products he had previously traded.

[1] Hurricane Ike made landfall on September 13, 2008 as a strong Category 2 hurricane. In part, because many smaller intrastate pipelines were shut down, decreased pipeline pressure on large interstate pipelines resulted in lower-than-normal flows for gas out of the Houston region creating a surfeit of supply. According to an EIA report, these pipelines returned to normal operating levels within a few days. *See* Energy Information Administration, *Impact of the 2008 Hurricanes on the Natural Gas Industry* (Dec. 2008), *available at* http://www.eia.gov/pub/oil_gas/natural_gas/feature_articles/2009/nghurricanes08/nghurricanes08.pdf.

The Texas team traders also had reasons to believe that their scheme would be hard to detect. First, the Texas team was trying to slow down the shrinkage of an already profitable spread rather than move physical prices in the direction that would benefit their financial position. Thus, there would be no suspicious price movements to draw attention to their increased selling at HSC. Second, before the manipulation began, the Texas team had a long Katy physical position and a short HSC financial position and access to BP-owned daily transport capacity to move their Katy gas to HSC. To implement the manipulation, the Texas team traders only had to expand their existing positions and exploit more of the transport capacity, rather than justify an entirely new trading strategy to their supervisors.

The Texas team's manipulative scheme was discovered when Luskie was at a BP-trader assessment and training program in November 2008 and tried to impress a senior BP official by explaining the Texas team's scheme to him. When the senior official questioned the propriety of the trading strategy, Luskie immediately called Comfort on a recorded line. On the November 5, 2008 recorded call, Luskie repeatedly asked Comfort for a legitimate explanation for the team's physical trading at HSC and their use of BP's Houston Pipeline (HPL) transportation capacity. Comfort's initial reaction was to cut off Luskie's questioning. When pressed further by Luskie, Comfort made a few short statements, interspersed by long pauses, which did not directly address Luskie's concern that the Texas team was manipulating the physical market to benefit the Texas team's financial position.

Despite Comfort's repeated interruptions, Luskie's statements on the recorded call were sufficient to provide staff with an outline of the Texas team's manipulative scheme in the "investigative period" (September 18, 2008 through the end of November 2008), which the underlying data confirmed. Specifically, BP's trading records demonstrate significant changes in the direction, volume, and timing of the Texas team's trading of physical gas during the manipulation. For example, in the months before the investigative period, the Texas team had been, alternately, a net buyer or seller of next-day physical gas at the HSC and Katy hubs. This variation made sense because the Texas team's stated arbitrage strategy was to capture opportunities between these hubs based on relative prices and transport costs. During the investigative period, however, the Texas team was a net seller at HSC for forty-eight out of forty-nine days and sold about four and a half times more physical gas at HSC fixed-price than they had the preceding two and a half months. In addition, BP's trading records show that in the investigative period the Texas team increased its next-day, fixed-price sales at HSC by taking larger gas positions at Katy and then shipping a greater percentage of this gas to HSC. The Texas team also began selling more heavily early in the daily HSC trading session in an apparent effort to influence the unfolding HSC physical market.

Staff found no economic justification for the Texas team's shift to heavier and earlier selling in the HSC next-day, fixed-price market. Moreover, using bid and offer data, intra-day prices, and end-of-day prices, staff discovered that while the Texas team was able to sell next-day, fixed-price gas economically at Katy during the investigative period, they were indifferent to higher priced opportunities when they sold at HSC. The Texas team also lost more money on their next-day, fixed-price physical trading at HSC in the investigative period and these losses were reflected on the Texas team's trading records on a daily basis.

In the Report below, staff presents its factual and legal findings in seven parts. Part II analyzes the November 5, 2008 recorded call in detail and shows that Luskie had the intellect and experience to understand and explain the Texas team's trading strategy at HSC. Comfort's responses on the call, brief and sharp, are best heard as a determined effort to cut Luskie off before he revealed more damaging information on a recorded line. This Part also analyzes Comfort's efforts to explain his trading at HSC and his motive for initiating the manipulative scheme.

Part III sets forth the building blocks of the manipulative scheme: the financial position that benefited from the suppression of the HSC physical market; the Katy and HSC physical positions that provided the gas to sell into the HSC fixed-price market each day; the HPL transport capacity that the Texas team used to transport their Katy gas to HSC; and the shift to net selling at HSC in the investigative period.

Part IV examines the Texas team's fixed-price physical trading and transport in the investigative period and focuses on the significant changes in the Texas team's physical trading pattern during the investigative period. This Part also shows that much of the Texas team's increased transport of gas from Katy to HSC was uneconomic.

Part V explains the likely motivation for the manipulation in the aftermath of Hurricane Ike in mid-September 2008, including why the Texas team correctly anticipated that the profits on their financial position would outweigh losses on fixed-price trading. This Part also explains how the unique circumstances created by Hurricane Ike provided a low risk of detection of the manipulation. Lastly, this Part examines the Texas team's fixed-price gas trading on a few specific days to show how the Texas team traded physical gas to suppress the HSC market to benefit their financial position.

Part VI examines BP's response to the disclosure of the recorded call. Because Luskie also talked to a member of BP's Independent Monitor[2] staff on the same day as

[2] BP was required to install the Monitor to oversee certain trading activities of BP Products North America (BP Products) in the commodities markets as a result of a 2007 settlement that BP Products entered with the CFTC and a related deferred prosecution agreement it entered with the Department of Justice. The 2007 settlement and related deferred prosecution agreement resolved allegations that BP Products manipulated, attempted to manipulate, and cornered the market for TET propane in April 2003 and

the recorded call, BP knew from the outset that there would be regulatory oversight of its response to Luskie's concerns. However, BP's Compliance department[3] minimized Luskie's concerns, ignored relevant trading, and failed to critically examine the trade data, ensuring that this internal inquiry would find no wrongdoing.

Part VII explains how the Texas team violated the Commission's Anti-Manipulation Rule (18 C.F.R. §1c.1).

Part VIII provides staff's application of the Penalty Guidelines to the facts of this case and staff's calculation of disgorgement.

Based on the facts staff presents in the report below, staff recommends that the Commission issue an Order to Show Cause and Notice of Proposed Penalty to BP requiring it to show cause why it did not violate section 1c.1 of the Commission's regulations in connection with BP's participation in trading and transportation activities in and around HSC from mid-September 2008 through November 2008, should not pay a civil penalty in the amount of $28,000,000, and should not disgorge unjust profits it received as a result of the Texas team's manipulation of the HSC *Gas Daily* index in the amount of $800,000.

II. A Recorded Call Reveals the Texas Team's Manipulation Scheme

A. The Factual Background of the Recorded Call

In early November 2008, Luskie, a junior member[4] of the Texas team attended the Assessed Trader Course (ATC), an offsite BP assessment and training program for

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February 2004. *See CFTC v. BP Products North America, Inc.*, 1:06-cv-03503 (N.D. Ill. Oct. 25, 2007); *United States v. BP America Inc.*, 07-cr-683 (N.D. Ill. Oct. 30, 2007).

[3] The formal name of BP's compliance department with oversight of the Texas team is "BP Integrated Supply and Trading Compliance" or "BP ISTC." Throughout this memo, however, it is referred to as "Compliance" or "BP Compliance."

[4] Beginning in August 2008, Luskie was a "Trade Analyst" on the Texas team desk. BPL F2 00094009. Luskie's primary trading responsibility was to optimize BP's transportation capacity on the Kinder Morgan Tejas pipeline. Deposition of Nesha Barnhart (Mar. 18, 2009) (Barnhart Dep.) at 138:15-18. He also performed daily position tracking, profit and loss calculations, and fundamental analysis. Deposition by CFTC of Clayton Luskie (Feb. 11, 2009) (Luskie CFTC Dep.) at 25-29; Barnhart Dep. at 138:19-21.

aspiring traders.[5] The ATC included trading simulations conducted in each trainee's hotel room. On November 5, 2008, James Parker (Parker), Head of Trading for BP North, stopped by Luskie's room during a lull in a simulation to have a conversation with him. At some point in their conversation, Luskie "made it sound as if [the Texas team] traded [their] physical position in order to affect [their] paper position."[6]

Parker became concerned and told Luskie that his statements "could be perceived as market manipulation."[7] Parker suggested that Luskie "talk to [his] manager and make sure [he was] not doing anything . . . wrong . . . ."[8] Luskie admitted that he was "absolutely freaked out" by Parker's reaction,[9] and he called Comfort, the Texas team trader primarily responsible for trading physical gas at HSC, as soon as his schedule allowed.[10] Because Luskie called Comfort on his number at the trading desk, BP recorded the phone call.

[5] The ATC is a rigorous internal BP program designed to determine whether candidates have the ability for speculative trading. Deposition of Angela John (Mar. 11, 2009) (John Dep.) at 31:15-21; 161:11-22. The pass rate for ATCs BP-wide is twenty to thirty percent. John Dep. at 138:13-15; BP's John Interview Summary (Dec. 4, 2008) at BP-L 00000129.

[6] Luskie CFTC Dep. at 201:14-17.

[7] Deposition of James A. Parker (Mar. 4, 2009) (Parker Dep.) at 53:12-13. Parker said he was "really surprised that [Luskie] said what he did. And I -- I thought that either he was just trying to show how clever he could be somehow in a naive, misguided way or that he – or that there was actually a problem." Parker Dep. at 54:15-19. After talking to Comfort, Luskie found Parker in the cafeteria and told him that he had misunderstood. Parker Dep. at 100:14-18. Parker testified that his subsequent conversation with Luskie did not allay his concerns. Parker Dep. at 104:4-7; 123:14-17 ("You know, in my mind, I thought that there was a chance that [Luskie] was telling me the truth and that there wasn't -- there was not a compliance issue in his team. I still thought there could be.").

[8] Luskie CFTC Dep. at 201:21-202:3.

[9] Luskie CFTC Dep. at 202:4-5; John Dep. at 93:15-16 (testifying that Luskie looked visibly upset).

[10] Luskie's manager was Kevin Bass. Bass died on June 20, 2009 before staff could depose him.

The recorded call begins with a few pleasantries, but Luskie quickly told Comfort that he, "need[ed] some help . . . on something."[11] Luskie explained that he met Parker and that they discussed some aspects of trading gas. At this point in the conversation, Comfort was mostly silent and expressed no concern about what Luskie was telling him. Luskie then stated:

> So I was telling him how we, you know what, *what we were doing at Ship Channel this month* and you know he just started asking me about you know what, kind of, what we do, *and strategy* and what not, and I was telling him *about our HPL transport* and the way I explained it was not very good and I came off sounding like we either we transport or don't transport solely on the um, kind of the, the . . . *how we think it's going to affect the index and help our paper position,* which as I was explaining I realize that's not right and that's the exact same thing that we're sort of accusing [Company A] of currently.[12] So how would you explain our, um, *our dealings on HPL and with our paper position* that don't make it sound like we're *manipulating the index*?[13]

B. Luskie Understood the Texas Team's Strategy at HSC

The first part of the recorded call provides an outline of the Texas team's scheme. Luskie's initial statements to Comfort on the recorded call establish that the Texas team had a specific trading strategy at HSC in this period. Luskie's statement, "what we were doing at Ship Channel this month," shows he was aware that the Texas team was "doing" something at HSC. Also, Luskie's use of the term "we" reflects that this strategy included the other Texas team traders.

Luskie next revealed that BP's capacity on HPL was a component of the Texas team's HSC trading strategy because he seamlessly moves from the HSC "strategy and what not" to relating that he told Parker "about our HPL transport." Because Luskie was

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[11] *See* Appendix A for the audio of the Luskie/Comfort recorded call (hillb6_G.WAV_4CE.WAV (Nov. 5, 2008). *See* Appendix B for the transcript of the Luskie/Comfort recorded call.

[12] The traders subsequently learned that [Company A] had not been responsible for these trades.

[13] Appendix A (emphasis added). Although Comfort starts to talk over Luskie, a listener can hear Luskie say "manipulating the index" under Comfort's voice. A paper position is synonymous with a position in financial products. Deposition by CFTC of Gradyn Comfort (Feb. 18, 2009) (Comfort CFTC Dep.) at 34:14-16.

trying to impress Parker,[14] Luskie made clear that the Texas team's use of its transportation asset was distinctive from the Texas team's ordinary use of the HPL capacity (which was to transport gas when it was economic to do so) when he stated that he told Parker "either we transport or don't transport solely on . . . how we think it's going to affect the index and help our paper position."[15]

Luskie testified that his explanation of the Texas team's HSC strategy to Parker, and to Comfort on the recorded call, was the result of confusion and stress, and he denied that the Texas team had engaged in market manipulation.[16] In fact, ever since Comfort and Luskie spoke on their cell phones immediately after the recorded call, Luskie has disavowed any knowledge of improper trading by the Texas team, even in the face of evidence that corroborated his outline of the manipulation.[17]

However, Luskie had the intelligence and experience to understand and correctly explain the Texas team's trading strategy at HSC to Parker. BP was sufficiently impressed with Luskie to select him for its Challenger program,[18] and his supervisors nominated him to attend the ATC.[19] Moreover, he was one of only two trainees to pass this administration of the ATC.[20] His ATC evaluation states:

> [Luskie] consistently performed at a high level and understood almost all concepts. [Luskie] could comprehend all of the fundamental information

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[14] Luskie CFTC Dep. at 201:9-11.

[15] Appendix B.

[16] Luskie CFTC Dep. at 204:7-205:6.

[17] Deposition of Clayton Luskie (Feb. 15, 2013) (Luskie Dep. Vol. II) at 440:13-442:10 (testifying that he had no recollection whether the string of forty-eight out of forty-nine days of net selling at HSC was related to his concerns in the recorded call); Luskie Dep. Vol. II at 463:18-25 (no recollection of whether the increase in selling in the first five minutes of trading at HSC in the investigative period was related to the concerns he expressed in the recorded call).

[18] John Dep. at 32 (The Challenger program, now called the graduate development program, is for graduates coming out of college and is typically a three-year rotational program to develop skills for on the job).

[19] To attend the ATC, managers had to nominate employees they felt were ready for the course. Luskie CFTC Dep. at 35:18-36:4.

[20] John Dep. at 40:5-12; Luskie CFTC Dep. at 290:1-3.

> and used it . . . appropriately [in the trading simulations]. He was very confident in what he did and could explain the rationale behind all of his trades.[21]

Luskie's responsibilities on the Texas team also required a thorough understanding of the team's positions and the daily profit and loss (PnL) calculations.[22] In fact, Luskie created a new daily spreadsheet – "the Texas Fun Sheet" – which had all the Texas team's positions (i.e., both physical and financial), and the previous day's PnL marks for those positions, in one place.[23]

At the time of the recorded call, Luskie had been on the Texas team for five months and had daily opportunities to listen to Comfort and Barnhart talk about trading strategies.[24] In fact, in an earlier recorded phone call, Luskie demonstrated that he comprehended the relationship between the daily HSC fixed-price market and the PnL on the Texas team's HSC-Henry Hub financial spread position. On November 3, 2008, after the first day of the ATC, Luskie called Comfort and Barnhart on a recorded line and after briefly talking about the ATC, Luskie asks them how "Ship" did that morning.[25] Barnhart responds that Ship was "strong," and Comfort added, "Brutal."[26] Barnhart then says, "we'll survive" and "we'll make money somewhere else."[27] Barnhart further noted that Carthage was weak and Luskie responds, "you'd much rather that be happening at Ship than Carthage."[28] Barnhart and Comfort concur with Luskie, and Barnhart

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[21] BP-L 00000085.

[22] Luskie's duties included reconciling BP-generated position reports with the Texas team traders' daily PnL numbers. Comfort CFTC Dep. at 62:11-63:15.

[23] Luskie CFTC Dep. at 104-105, 109:15-18, 120-121. The primary purposes of the Texas Fun Sheet were position tracking, profit and loss estimation, and daily checkout. Affidavit of Mark A. Galicia in Response to March 25, 2009 Second Data Request, Question No. 2 (Apr. 1, 2009). Comfort and Barnhart considered Luskie's "Texas Fun Sheet" an improvement and used it to keep themselves informed of their positions. Comfort CFTC Dep. at 131:18-133:21; Barnhart Dep. at 51:17.

[24] Luskie sat next to Comfort and Barnhart and he testified that he listened to and participated in their conversations about trading views and strategy. Luskie CFTC Dep. at 77:4-7.

[25] Audio recording produced by BP as adamd2_WAV_CD.wav (Nov. 3, 2008).

[26] *Id*.

[27] *Id*.

concludes with, "everything else is a piece of crap except where we are short."[29] Luskie noted his agreement and ended this part of the conversation by saying that they "still had 26 days to go [in the month]."[30]

The November 3 recorded call shows that Luskie understood that Comfort and Barnhart wanted HSC fixed-price gas prices to weaken relative to other points, even as the Texas team was selling significant volumes of physical gas at HSC each day. Because a physical gas seller would generally prefer that physical prices move higher, the Texas team's desire for the HSC physical market to weaken only made sense if the Texas team's financial position at HSC was more important to the traders (because it held the potential for larger profits).[31]

C. Comfort's Reaction to the Recorded Call

Luskie's call created a dilemma for Comfort because Luskie's initial question went to the heart of the manipulation scheme: *"So how would you explain our . . . our dealings on HPL and with our paper position that don't make it sound like we're manipulating the index?"*[32] Instead of telling Luskie that he had some basic misunderstanding of the Texas team's trading at HSC, Comfort provided no such reassurance and no direct answer to Luskie's question.

This section shows that Comfort tried to limit the damage from Luskie's pointed questions first by interrupting Luskie, and after Luskie persisted, by providing responses that failed to directly address Luskie's primary concern. Although Comfort later conceded that his reaction on the recorded call was poor,[33] he asserts that he was in shock

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[28] *Id*.

[29] *Id*.

[30] *Id*.

[31] *See* Luskie Dep. Vol. II at 351-52 (acknowledging that the spread position had a much greater potential for profit or loss than fixed price trading). Luskie's comment about having "26 days to go" shows that Luskie understood how the spread position worked -- that the Texas team could still make money on the position if HSC physical prices weakened over the next 26 days of November because the HSC *Gas Daily* index was a monthly average of daily HSC physical gas prices.

[32] Appendix B.

[33] Deposition of Gradyn Comfort (June 15, 2010) (Comfort Dep. Vol. III) at 464:2-5.

from having the ethics of his trading questioned.[34] Comfort's post-call behavior, however, was inconsistent with this assertion.

1. Comfort's Initial Silence and His Interruptions

Comfort's initial silence on the call reflects that Comfort shared Luskie's understanding that the Texas team had a specific trading strategy in place at HSC.[35] Otherwise, it is likely he would have asked Luskie what Luskie meant by "*what we were doing at Ship Channel this month.*"[36]

Comfort only broke his silence on the call when Luskie asked him how to explain the Texas team's HPL transport in a way that did not make it sound like they were using it to manipulate the index.[37] At this point, Comfort barked out, "Clayton, Clayton!" and talked over Luskie, so that the words – "manipulate the index" – are barely audible.[38] Only when Luskie stopped and responded, "Yeah," did Comfort offer a substantive comment: "Clayton, um, I, I think . . . [pause, sighs] most of the time we ship economically."[39] Luskie says, "Right," but Comfort was hesitant in his continued response, saying "And uh, the um . . ." Luskie followed with another attempt: "I mean, it's just that we're not . . ."[40] This time, Comfort's "Clayton, Clayton" prevented Luskie from finishing that thought.[41] Comfort then added a little more information, stating,

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[34] Comfort Dep. Vol. III at 463.

[35] Comfort testified that he could not recall what he understood Luskie to be referring to when he said "what we were doing at Ship Channel this month" or Luskie's reference to a "strategy" at HSC. Comfort Dep. Vol. III at 471:3-19.

[36] Appendix B.

[37] *Id*. Comfort agreed that he must not have been initially upset about the way that Luskie described Texas team's HPL transportation practices because he did not interrupt him. Deposition of Gradyn Comfort (July 7, 2010) (Comfort Dep. Vol. IV) at 688:22-23; 689:14-15; 708:10-709:13 (recalling that he called Luskie to "ream him out" for making an "inappropriate reference" but that he did not criticize Luskie for anything he had said regarding the HPL transport practices).

[38] Appendix B.

[39] *Id*. Comfort could not remember what Luskie said that made him start talking about shipping economically. Comfort Dep. Vol. III at 423-25.

[40] Appendix B.

[41] *Id*.

"You know, the, the, the, there's times we, we, we can't unwind all of our positions but most of the time we attempt to ship economically."[42]

Luskie once more tried to broach the same topic again by asking, "Is it just that we're not…"[43] However, Comfort interjected and again stopped Luskie from completing this question. Comfort's next words were "[A]nd then um, the um, the um aspects that go into cash I think are um, are multiple and uh . . . [pause, sighs] . . . just give me a second here okay?"[44] Then, while waiting for Comfort to finish his response, Luskie asked if he could call Comfort back. Comfort responded, "Yeah that'd be a good idea."[45]

Comfort's interruptions and sharp tone reflect that his objective was to prevent Luskie from stating more information about the Texas team's trading practices on a recorded line. Even Parker conceded that after listening to the recorded call, he was "less confident" that the Texas team traders had not done anything wrong from "just the tone that [Comfort] used in the phone call."[46]

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[42] *Id*.

[43] *Id.*

[44] *Id*.

[45] *Id*. Only after the third interruption did Luskie realize that Comfort did not want to have this conversation on a recorded line. Luskie Dep. Vol. I at 23:6-25:12. While a moment before, Luskie was eager and even insistent on obtaining an explanation from Comfort to assuage Parker's concerns, Luskie suddenly needs "to run." However, Luskie's claim at the end of the recorded call that he had "to run" is belied by the fact that he immediately called Comfort back on Comfort's cell phone. The recorded call was made from Luskie's cell phone to Comfort's recorded line at 11:16 a.m. and lasted for approximately three minutes. BP-L 00146008 (Luskie cell phone bill). Cell phone records reflect that Luskie then called Comfort's cell phone at 11:19 a.m. – less than a minute after the recorded call ended. *Id*. Comfort may not have answered this call because he was on trading floor at the time where cell phone conversations were restricted. Luskie Dep. Vol. I at 29:9-16. Comfort then called Luskie's cell phone at 11:22 a.m. and spoke for ten minutes. BP-L 00146008. Luskie and Comfort had another nine-minute conversation at 12:48 p.m., when Luskie again called Comfort's cell phone. *Id*.

[46] Parker Dep. at 193:17-22.

2. Comfort's Explanations and Extended Pauses

Luskie's persistence on the recorded call caused Comfort to offer three short responses.[47] These responses are important because the recorded call provides Comfort's only unrehearsed attempts to explain his trading behavior. His responses to Luskie were as follows:

- "Clayton, um, I, I think . . . [pause, sighs] most of the time we ship economically."[48]
- "You know, the, the, the, there's times we, we, we can't unwind all of our positions but most of the time we tend to ship economically."[49]
- "Clayton . . . and then um, the um, the um aspects that go into cash I think are um, are multiple and uh . . . [pause, sighs] . . . just give me a second here okay?"[50]

Initially, it is noteworthy that Comfort's responses speak only to whether the Texas team was shipping "economically" and not to Luskie's direct question of whether the Texas team's trading strategy at HSC was designed to manipulate the index. Comfort's statements about the transportation issue are nevertheless relevant for what they imply. When he says, "I think . . . most of the time we ship economically,"[51] Comfort reveals that he is cognizant that the Texas team has been shipping uneconomically to HSC at least some of the time. Moreover, his attempt to blame any non-economic transport on the alleged difficulty in unwinding the Texas team's positions showed that he knew he needed an explanation for repeated instances of uneconomic transport.

Finally, after two brief comments about economic shipping, Comfort shifted to talking about "aspects that go into cash" that "are multiple," but he then stopped and told Luskie he needed more time to think.[52] In fact, the recorded call shows long and telling

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[47] The fact that they were on a recorded line limited Comfort's options. For example, Comfort could not reveal the scheme and try to garner Luskie's silence.

[48] Appendix B.

[49] *Id*.

[50] *Id*.

[51] *Id*.

[52] *Id*.

pauses before each of Comfort's responses.[53] An experienced trader, such as Comfort whose primary job on the Texas team included daily physical gas trading at HSC, should have been readily able to explain why his trading was not manipulative.[54] Taken together, Comfort's brief responses and the extended pauses evidence that he had no coherent explanation for his HSC fixed-price trading and his use of the HPL transport.

3. Comfort's Post-Call Behavior

Comfort testified that his interruptions and failure to give Luskie a full answer to Luskie's questions were caused by shock and surprise.[55] The credibility of Comfort's explanation is undermined by his post-call behavior – which was much more consistent with a continued effort to muzzle Luskie and to construct a *post hoc* justification for the Texas team's uneconomic trading at HSC.

First, Comfort and Luskie immediately continued their conversation on two unrecorded cell phone conversations. Comfort initially claimed he wanted to speak with Luskie on an unrecorded line because he was going to "chew[] [Luskie] out" for "having made such a mistake of inappropriate nature," and that wasn't "something that necessarily needs to be recorded."[56] Upon further questioning, however, he admitted he did not want the second call recorded because "You just don't know what somebody is going to say and make another – make something better or worse."[57] Comfort's words

[53] There is an approximately fifteen-second pause before Comfort made the simple statement that "I think . . . most of the time we ship economically." Appendix A. Likewise, there is ten seconds of dead air before he referred to "unwind[ing] . . . positions." *Id*. Then there is another fifteen-second pause before his last fumbling attempt at an answer. Finally, there is a fifteen-second pause after Comfort asked for "a second here" and before Luskie realized he had "to run." *Id*.

[54] By 2008, Comfort had been in the gas business for seventeen years. Comfort CFTC Dep. at 16:5-21:14. At BP, Comfort shifted to primarily financial trading in 2003. *Id*. at 24:11-25:9. Luskie testified that Comfort was generally good at explaining things and that he could not recall Comfort ever being at a loss for words when asked a question about the Texas team strategy. Luskie Dep. Vol. I at 44:23-46:4. *See also* Deposition of Stephen Simmons (Feb. 19, 2013) (Simmons Dep.) at 153:6-11.

[55] Comfort Dep. Vol. III at 483:23-484:3.

[56] Comfort Dep. Vol. III at 485:5-7.

[57] Comfort Dep. Vol. III at 487:4-11. BP policy required that Comfort leave the trading floor to have a cell phone conversation. *See* IST Business Communications & Recording at BP-L 00000418-19.

indicate his concern that Luskie would continue to divulge damaging information about the Texas team's trading practices if they resumed their conversation on a recorded line.

Second, Comfort's recall of the cell phone calls was limited to two facts: (1) that he cursed and yelled at Luskie for comparing his trading to possible illegal conduct by another market participant, and (2) that at the end of the second conversation, they mutually agreed that they had to report the recorded call to the head of the Texas team, Kevin Bass.[58] Comfort had no memory, however, of whether he explained to Luskie – in either of these cell phone calls – why Luskie's belief that the Texas team was using transport to affect the index and help their paper position was wrong.[59] Moreover, Comfort could not recall any discussion in the days or weeks that followed in which he explained to Luskie why his description of the Texas team's trading practices to Parker or on the recorded line was inaccurate.[60]

A reasonable conclusion to be drawn from his post-call behavior is that if Luskie had incorrectly described the Texas team's trading to Parker, Comfort would have had a detailed conversation with Luskie to make sure he understood the Texas team's trading strategy and why it was not market manipulation. And, if Comfort's goal was to avoid having to explain his trading practices, he would have done exactly as he did: stifle Luskie's questions on the recorded call and then never again discuss the substance of his concerns with him.[61]

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[58] Comfort Dep. Vol. III at 486:17-23; 509:24-510:1; Comfort Dep. Vol. IV at 708:12-22; Luskie CFTC Dep. at 222:11-15. As explained in Part VI, Luskie had already talked to a member of the external Monitor staff, ensuring that BP management would learn of the recorded call.

[59] Comfort Dep. Vol. III at 489-90 (testifying that he could not "recall a discussion about specific things around trading in particular," and did not remember if he "was simply in a mode to chew [Luskie] out or if I corrected him at that time.").

[60] Comfort Dep. Vol. III at 638:4-12 ("I said earlier I didn't recall what level of discussion I've had with Clayton. It could be as simple as saying that was wrong . . . I don't recall whether we had a detailed discussion. . . . But if there were an ongoing deficiency in his knowledge and we needed to fill that in, we would have.").

[61] Luskie's memory about the subsequent cell phone calls is also suspect. He repeatedly testified that Comfort helped him "organize" his thoughts but agreed that Comfort did not disclose any new information about the Texas team's trading strategy. Luskie CFTC Dep. at 215:17-216:1; 217:19-21. Luskie testified that he met with Comfort and Barnhart when he returned to the office a few days later in a conference room and just apologized and tried to clear the air. Luskie CFTC Dep. at 224-25. Staff concludes that Luskie's lack of memory about the later conversations and his claim that

4. Comfort's Motive to Manipulate

A discussion of Comfort's credibility cannot ignore his pressing need to improve his trading performance in 2008. Although Comfort testified that his transfer from the California desk to the SEGT Texas team in January 2008 was an opportunity, "not a necessity,"[62] that description is not supported by the facts. Comfort's California desk supervisor had told Comfort that he would have to leave that desk because of his weak trading results and his 2007 written review confirms that Comfort's transfer was involuntary.[63] Upon moving to the Texas team in 2008, Comfort was initially a financial trader.[64] After only five months, however, BP changed his duties to primarily physical trading.[65] While not formally considered a demotion, trading financial products is generally much more remunerative because financial traders at BP receive "a higher percentage of the value they generate."[66]

Comfort also had reason to fear that BP viewed his weak trading performance in 2007 as an indication that his trading skills were not keeping up with market developments. In his August 2007 review, his supervisor stated:

> In his own trading Gradyn puts on positions which reflect his fundamental opinion, however at times I feel he has traded too much size in said positions and/or got into them too early. In the past this may have been acceptable because the market traded more fundamentally. However in recent times because the market has been more momentum driven, he has

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his concerns about the Texas team trading had been the product of a confused mind were an effort to protect himself, his teammates, and BP. As explained above, Luskie's grasp of the Texas team's trading and PnL was good and his outline of the manipulation is borne out by the trading records.

[62] Comfort CFTC Dep. at 26:8-11.

[63] Comfort's August 2007 evaluation states that he had "not generated any PnL vs. his 2007 . . . target." BP-L 00228485. The review also informs Comfort that "we are going to make a change" and that Comfort needed to seek out a "new opportunity within BP over the next two months." *Id*.

[64] BP First Partial Response to June 4, 2009 CFTC Data Request.

[65] *Id*.

[66] *Id*.; Luskie Dep. Vol. I 62:21-25 (stating Luskie's belief that Comfort preferred to trade financial products).

> been left with positions he has had to get out of due to losses which may not have been the case if the positions were smaller.[67]

Thus, with his trading acumen being questioned, it is a reasonable inference that Comfort believed he needed to have a strong performance in the second half of 2008.

The next three Parts present the evidence and analysis confirming that the market manipulation Luskie outlined on the recorded call occurred.

III. The Building Blocks of the Manipulative Scheme: The Texas Team's Physical and Financial Positions and BP's HPL Transport Capacity

BP's trade and transport records show the key pieces of the manipulative scheme Luskie outlined in the recorded call. First, BP's records reflect that in the investigative period, the Texas team held, and then expanded, monthly short-HSC financial positions that settled based on the monthly HSC *Gas Daily* index[68] – the index made up of all reported next-day, fixed-price physical trades (hereinafter also referred to as "fixed-price")[69] at HSC. Second, these records reflect that the Texas team grew their physical long positions at HSC and the nearby Katy hub to ensure they had an ample supply of physical gas to transport and sell into the fixed-price market at HSC to suppress the HSC daily market. Third, BP owned underutilized transportation capacity on HPL and the Texas team had largely unfettered use of this capacity to ship gas from Katy to HSC during the investigative period. Fourth, the trading and transport records show that the Texas team traders greatly increased their use of this HPL capacity and became net sellers of physical gas at HSC for forty-eight out of the forty-nine days in the investigative period.[70]

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[67] BP-L 00228485.

[68] Platts *Gas Daily* (McGraw Hill Financial), available at http://www.platts.com/products/gasdaily. As explained later in this Part, the Texas team also bought index swaps at Henry Hub to create a HSC-Henry Hub "swing spread" for these months.

[69] Next-day, fixed-price gas is a physical product that is bought or sold at a specified dollar amount at a location for delivery or receipt on the following day. Next-day, fixed-price gas can be traded through the Intercontinental Exchange (ICE) or bilaterally in the over-the-counter (OTC) market. While other products such as monthly gas can be traded at a fixed-price, for brevity, next-day, fixed-price gas shall be used interchangeably with "fixed-price" in this Report unless otherwise noted.

[70] BP reported all of its HSC fixed-price trades to Platts, and therefore, all of its fixed-price sales were included in the HSC *Gas Daily* index that set the value of its

A. The Texas Team's Financial Position in the Investigative Period

1. The Texas Team Built a Short Swing Swap Position at HSC

In mid-January 2008, the Texas team sold a seven-month strip of index swaps at HSC for April through October 2008.[71] Staff found no evidence to suggest that their decision to acquire this position was based on anything other than fundamental analysis of market forces for the coming year.[72]

After Hurricane Ike, however, the Texas team traders grew and managed their short-HSC financial position to benefit from their manipulation of the monthly HSC *Gas Daily* index. First, the Texas team began selling HSC index and swing swap contracts (collectively, the "HSC short swap position") for October and November.[73] At the beginning of October, the Texas team's short swap position was about thirteen contracts. In early October, the Texas team increased its HSC short swap position to about twenty-one contracts by selling approximately eight balance of month (BOM) swing swap contracts.[74]

The Texas team also increased their November HSC short swap position, and this increase was even more dramatic. Unlike the September and October HSC short swap positions, the Texas team had maintained a much smaller November HSC short swap position for the first three quarters of 2008.[75] In early October, the Texas team increased

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financial short position at HSC. Simmons Dep. at 182:11-183:3; *see also* Comfort Dep. Vol. II at 355:22-356:20.

[71] On September 1, 2008, the Texas team held about twenty-one September contracts per day. Unless otherwise noted, references to monthly contract positions refer to average contract size per day over the course of the month.

[72] Comfort testified that for October 2008, the Texas team had a general view that HSC prices would decline relative to Henry Hub. Comfort Dep. Vol. IV at 835-36.

[73] Index and swing swaps are monthly financial products that represent the daily flow of gas over the flow month. Traders talk about these swaps in terms of the number of contracts they represent per day (frequently in volumes of a NYMEX contract of 10,000 MMBtus). So, when a trader says he sold a swing swap contract "one per day," this generally means that he sold thirty contracts of 10,000 MMBtus for the month – totaling 300,000 MMBtus.

[74] The bulk of the BOM swing swap sales occurred between October 1-3, 2008.

[75] From January 2008 through October 8, 2008, the Texas team was never short more than seven November HSC index swap contracts.

their November HSC short swap position from about seven to twenty-three contracts – a 250 percent increase in two days. Later in October, they further grew that position to thirty-four contracts.[76]

The increase in the Texas team's October and November 2008 HSC financial position was also suspicious because Comfort, not Barnhart, executed the bulk of the financial trades that built the larger November HSC short swap positions (even though, beginning in June 2008, BP had limited Comfort's role on the Texas team to primarily physical trading).[77] Moreover, as the lead physical trader on the Texas team, Comfort played a primary role in the Texas team's decision (discussed below) to significantly increase the Texas team's November long physical positions at Katy and HSC (which the Texas team traders then used to suppress the HSC fixed-price market to benefit their financial position).

2. The Texas Team Built a HSC-Henry Hub Financial Spread Position

The Texas team's HSC short index and swing swaps in the investigative period, discussed above, were paired with long swaps at Henry Hub, creating a financial "swing spread" position between these two hubs.[78] The Texas team's swing spread between HSC and Henry Hub first appears in the spring and was maintained as a four- to fourteen-contract position through the early fall.[79] The traders entered September 2008 with a swing spread position of about thirteen contracts.[80]

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[76] The other significant change in the Texas team's November HSC financial position involved basis swaps. Going into October, the Texas team was slightly short November basis swaps. During October, the traders built a much larger thirty-five contract November HSC short basis swap position. The impact of the November HSC short basis swap position on the Texas team's PnL is discussed in Part V.

[77] For summer and fall 2008, Barnhart made the majority of financial trades for the team.

[78] A swing spread can be a combination of products in a trader's book rather than a discrete financial product. Thus, the intent to create a financial spread position sometimes must be established by trader statements or by a pattern on the trading book such as simultaneous purchases and sales of swaps at each location.

[79] In most months, the Texas team was short more HSC index and swing swaps than long Henry Hub index and swing swaps. Where there was a difference between the swap amounts, staff used the lower number to determine the spread size. The Texas team did not buy any Henry Hub index swaps in January 2008 when the April-October HSC index swap strip was sold. Later in the spring, however, the Texas team appears to have

In October, however, the Texas team increased their October HSC-Henry Hub swing spread position through BOM swing swap transactions. Thus, the Texas team began October 2008 with a thirteen-contract swing spread, but with the HSC BOM swing swap sales, grew the position to an average of about twenty-one contracts for the month. Also in October, the Texas team grew their November swing spread position to twenty-four contracts to start November.[81] The growth of the swing spread position in the investigative period can be seen below in Figure 1.

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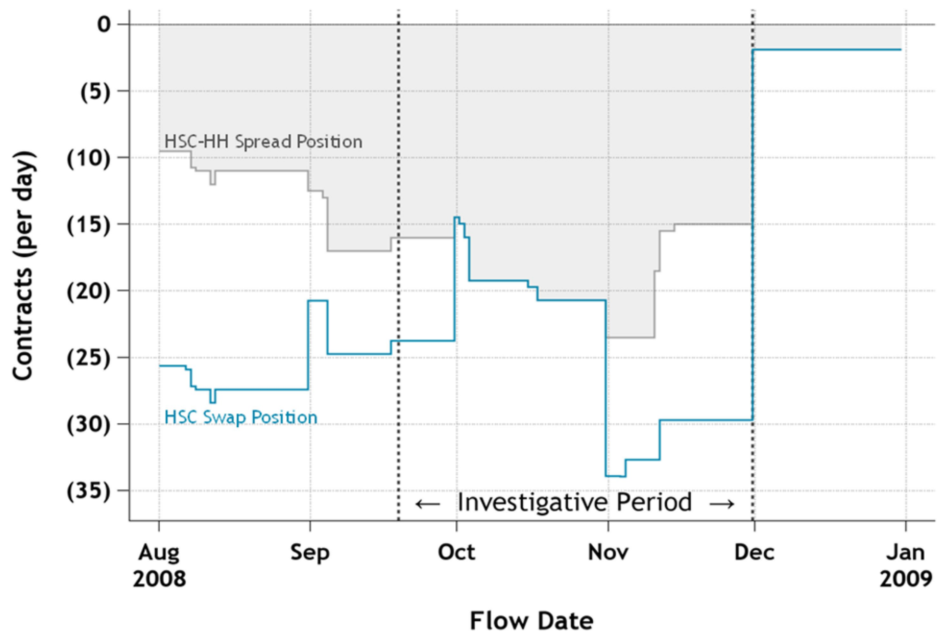
built a four-contract swing spread for May and June 2008, a fourteen-contract spread for July and a ten-contract spread for August 2008.

[80] BP contends that the Texas team traders viewed their physical and financial positions as well as all their "HSC related positions" in Texas in the aggregate, hence staff's portrayal of the HSC-Henry Hub financial "swing spread" as a distinct position in these months is not accurate. *See* Affidavit of Souad Mahmassani in Response to June 6, 2012 Tenth Data Request, Question No. 45 (July 6, 2012) at 2; Question No. 47 (July 6, 2012) at 2; Luskie Dep. Vol. I at 286-288; 299. However, while the Texas team may have aggregated their physical and financial positions in Texas to evaluate risk, there is ample evidence that the traders followed their long and short financial swaps at HSC and Henry Hub as a distinct financial spread position with exposure to the *Gas Daily* index. First, the "Texas Fun Sheet," created by Luskie, had separate entries for the team's financial and physical positions in each month. More specifically, on Sept. 12, 2008, in response to a request from Bass to describe each trader's positions, a Barnhart email states that the Texas team had "300K *short hsc vs hub spread financially in September*." BP-L 00176892 (emphasis added). Similarly, during the first three days of October, without making any adjustments to the Texas team's physical index positions, Comfort sold and bought equal quantities of HSC and Henry Hub balance-of-month ("BOM") swing swaps, reflecting an intent to increase the Texas team's October financial swing spread position. For November 2008, Comfort agreed that the Texas team had a "financial position [on that was a] Henry Hub-Houston Ship Channel spread" and that "spread position settled financially on a daily basis." Comfort Dep. Vol. III at 628:11-20; 629:5-13.

[81] The recorded call was disclosed to the BP Monitor and regulatory agencies in early November 2008. From November 7, 2008 through November 11, 2008, Comfort reduced the Texas Team's November swing spread by approximately 8 contracts by selling BOM Henry Hub swing swaps. During bid week of November 2008, the Texas team took minimal swing swap positions for December 2008 at both HSC and Henry Hub.



The shaded area shows the HSC-HH spread position (determined by the smaller of the HSC short swap and HH long swap positions).

Figure 1

B. The Texas Team's Monthly Physical Gas Positions at Katy and HSC

This section lays out how the Texas team acquired long physical positions at Katy and HSC during the investigative period to give them a greater supply of gas that they could then transport and sell into the fixed-price market at HSC to facilitate the manipulative scheme.

1. The Katy Physical Position

Throughout the investigative period, the Texas team held a long physical position at Katy that obligated them to take delivery of physical gas at Katy every day in the month. As of August 1, 2008, the Texas team's Katy long positions for September and October 2008 were about thirteen contracts each.[82] For the first half of September, the Texas team kept their October Katy long position static. However, beginning on September 18, 2008 (the week staff alleges the Texas team's manipulation of the HSC

[82] The Texas team started September 2008 long nine September Katy contracts. During September, the Texas team's September Katy long position grew to approximately eighteen contracts. Katy Excel Spread Sheet at BP-L 00147472; BP-L 00146151; BP-L 00146158; BP-L 00146144; and BPL F2 00093844.

physical market began), the Texas team began buying more Katy gas for October which increased their October Katy long position by eighty percent.[83]

During October, the Texas team made even more significant purchases of Katy gas for November. Before the investigative period began, the Texas team had a marginal November long physical position at Katy.[84] Beginning in mid-October and continuing through the month, however, the Texas team grew their Katy November long position to twenty-two contracts.[85]

2. <u>The HSC Physical Position</u>

In addition to trading their own physical position, the Texas team traders also had the responsibility of trading the daily HSC physical gas positions established by other SEGT traders. As a result, the daily gas position the Texas team had to trade each day at HSC was a combination of their own HSC position plus the other SEGT traders' HSC positions.[86]

Other SEGT traders held short positions in monthly gas at HSC during September, October, and November 2008. To fulfill this daily short obligation, the Texas team traders had to either buy physical gas in the HSC market, or transport gas that BP owned elsewhere to HSC. Over the investigative period, the Texas team traders reduced SEGT's overall HSC short position by buying HSC contracts for these months. As a result, the net SEGT position at HSC went from short ten contracts in September, to short six contracts in October, down to short one contract in November. The change in SEGT's overall HSC physical position from short to almost flat over the course of the investigative period was primarily due to net purchases of HSC monthly gas by the Texas team. The result was also an overall larger net long position in daily physical gas (net

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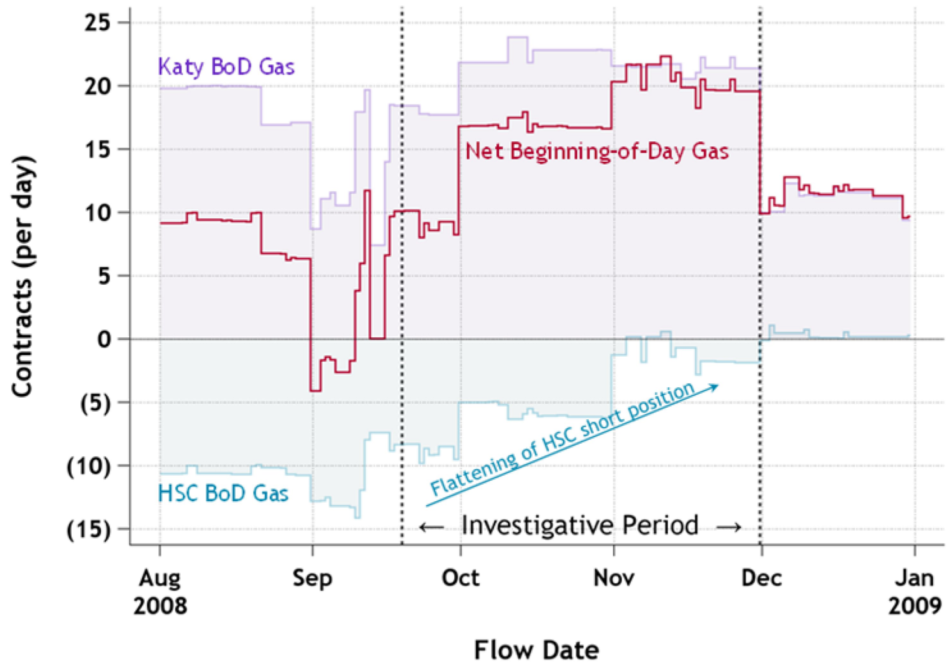
[83] The Texas team began October with approximately twenty-two Katy contracts. Katy Excel Spread Sheet at BP-L 00147472; BP-L 00146151; BP-L 00146158; BP-L 00146144; and BPL F2 00093844.

[84] As of September 1, 2008, the Texas team had approximately two November contracts at Katy.

[85] The Texas team ended November with about twenty-one Katy contracts. For December 2008, after the manipulative scheme ended, the Texas team had, on average, only eleven Katy contracts for the month. Katy Excel Spread Sheet at BP-L 00147472; BP-L 00146151; BP-L 00146158; BP-L 00146144; and BP-L F2 00093844.

[86] The Texas team also traded all SEGT physical positions at Katy. In the investigative period, however, the net position of other SEGT traders at Katy was inconsequential.

beginning-of-day, or BoD gas) for the Texas team at Katy and HSC – the two points connected by their HPL capacity. *See* Figure 2.



The red line shows the overall long position of daily physical gas for the Texas team at Katy and HSC.

Figure 2

3. <u>The Increased Katy and HSC Long Positions</u>

While the Texas team took physical positions at Katy and HSC for a variety of reasons, including supplying gas to BP's industrial customers, no more than twenty-five percent of the Texas team's Katy gas in any given month went to meet existing contracts for these customers.[87] There is no evidence of any increased customer demand that required the Texas team to enlarge its October and November 2008 monthly physical positions at Katy and HSC. Moreover, Comfort testified that he chose to be long physical gas at Katy in this period because it provided him with "optionality" to sell fixed-price gas at either Katy or HSC. Thus, it is uncontroverted that the Texas team's increased long physical gas positions at Katy and HSC in the investigative period were a strategic choice by the traders and not the by-product of other BP obligations.

[87] Comfort CFTC Dep. at 172:10-14.

C. The Texas Team Used BP's HPL Capacity to Become a Net Seller of Physical Gas at HSC

In the recorded call, Luskie relates that he told Parker that the Texas team made decisions to transport gas on HPL based on how that would "affect the index and help [their] paper position."[88] In the investigative period, BP held 200,000 MMBtus of firm capacity on HPL from Katy to HSC.[89] This was the only pipeline on which BP had firm capacity into HSC but the capacity was underutilized even though BP had to pay HPL a daily rate regardless of whether it shipped any gas.[90] As a result, BP allowed the Texas team to use the HPL capacity for speculative arbitrage trading between Katy and HSC. As Comfort testified, the Texas team could "leave it empty or use it full."[91]

Consistent with Luskie's concern that the Texas team was using the HPL capacity to manipulate the HSC index, the Texas team traders greatly increased their use of BP's HPL capacity to transport gas to HSC in the investigative period. And, breaking with their prior trading patterns, they became net sellers of fixed-price gas at HSC for forty-eight of forty-nine trading days. *See* Figure 3. As explained in Part IV, shifting to net-selling fixed-price gas at HSC was essential to the manipulation because only fixed-price trades are used to calculate the *Gas Daily* index, and selling more gas at HSC worked to suppress the *Gas Daily* index and benefit their financial position.

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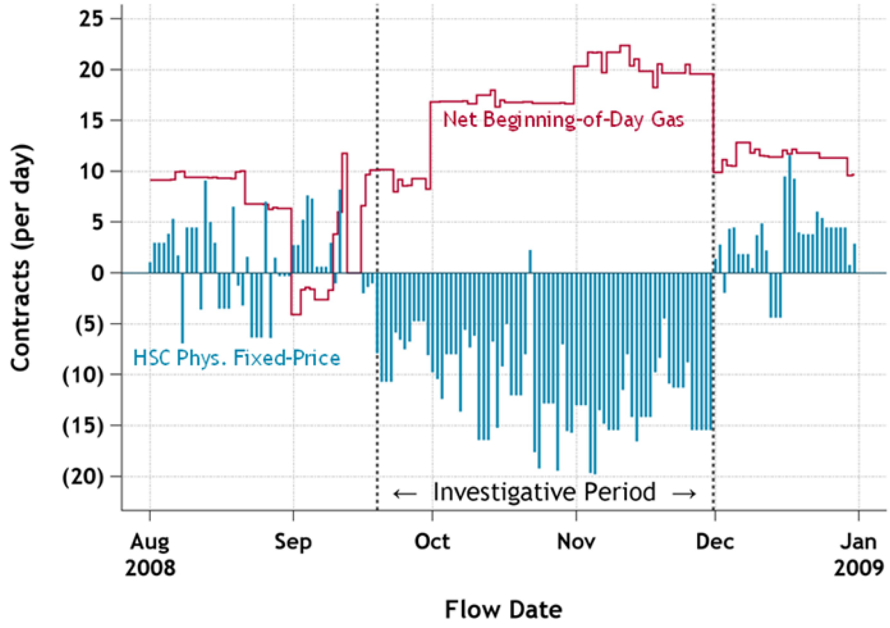
[88] Appendix B.

[89] Houston Ship Channel and Katy areas are approximately thirty miles apart and are connected by HPL. BP acquired this capacity as of April 1, 2006 for "flow assurance for BP equity gas production and for deliveries to BP facilities in Texas City." Affidavit of Patrick Clynes in Response to February 24, 2012 Ninth Data Request, Question No. 40 (Mar. 6, 2012). BP also states that this capacity was obtained to provide access to long and short term markets for BP's large customers. *Id.*

[90] BP paid a base rate of $0.03 per MMBtu for the capacity, plus an additional variable charge based on the price and volume of the gas. The variable charge during the investigative period was approximately $0.01 to $0.014 per MMBtu. The traders believed that the HPL capacity was "out of the money" – i.e., unprofitable in this time period. Comfort CFTC Dep. at 139-141; Luskie CFTC Dep. at 168:1-3.

[91] Comfort CFTC Dep. at 67:11-13. Comfort testified that he needed only about 40,000-60,000 of the daily 200,000 MMBtu capacity to meet the Texas team's physical gas obligations to BP's customers. Comfort CFTC Dep. at 172:10-14.



The Texas team used their increased Net Beginning-of-Day position to sell large volumes of gas at HSC for 48 out of 49 days in the investigative period.

Figure 3

Finally, the graph below shows how the Texas team became consistent and heavier net sellers of fixed-price gas at HSC at the same time they had a large financial spread position that benefited from weaker HSC fixed-price gas relative to Henry Hub fixed-price gas.

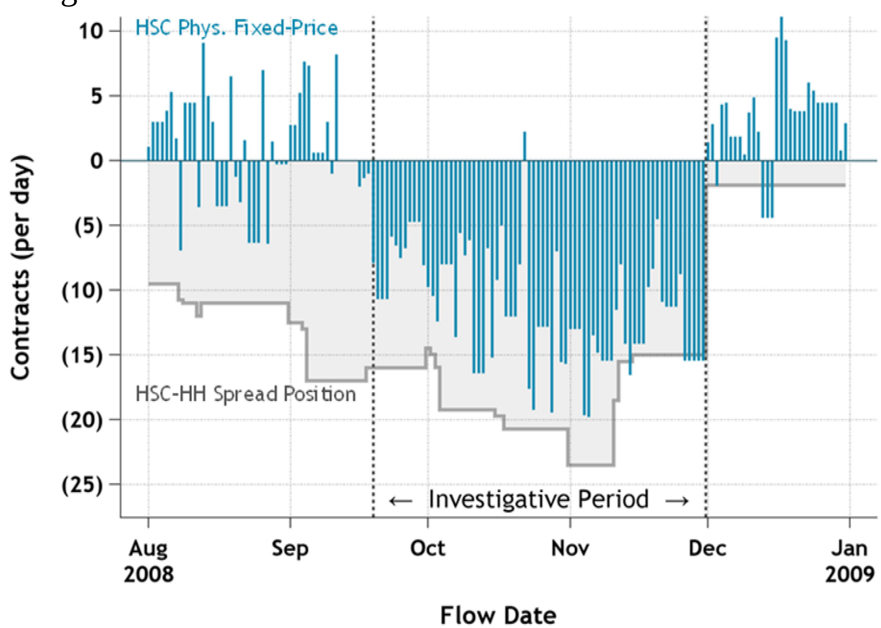


Figure 4

IV. The Texas Team's Physical Gas Trading and Transport Corroborate Luskie's Outline of the Manipulative Scheme

The Texas team's trade and transportation records corroborate the first half of Luskie's outline of the manipulative scheme – that the Texas team used physical trading and the HPL transport capacity to suppress the *Gas Daily* index at HSC. Part V explains how the Texas team's financial position benefited from the manipulation.

This Part first explains why the increased monthly physical positions at Katy and HSC were critical to the scheme. Second, it shows how the Texas team used the HPL transport capacity to move more gas from Katy to HSC in the investigative period. Third, this Part shows how the Texas team changed its trading patterns at HSC, including observable changes in the direction, volume, and timing of their fixed-price physical gas sales at HSC compared to both before and after the investigative period. Fourth, it presents staff's analysis of BP's trading data using both intra- and end-of-day HSC and Katy prices and intra-day bid and offer data. This analysis demonstrates that a significant percentage of the transport from Katy to HSC was uneconomic (i.e., that there were no price incentives justifying the Texas team's shipment of so much of its Katy gas to HSC), corroborating Luskie's concern that the Texas team was transporting Katy gas to HSC to manipulate the index.

A. The Texas Team Used Their Larger Net Physical Gas Position in the Investigative Period to Facilitate the Manipulative Scheme

This section explains how the Texas team's decisions to take larger long physical positions at Katy and to reduce SEGT's overall short physical positions at HSC facilitated the manipulative scheme.

1. <u>The Texas Team First Acquired a Steady Supply of "New" Gas to Flow to HSC</u>

The goal of the manipulative scheme was to suppress the HSC *Gas Daily* index to benefit the Texas team's financial position. To suppress the HSC *Gas Daily* index, the Texas team needed to create daily, downward pressure on the HSC fixed-price market because each day's price (the HSC *Gas Daily* daily index or GDD) generally constituted 1/30 of the monthly HSC *Gas Daily* index upon which the financial position settled.[92]

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[92] For months with thirty-one days, each day constitutes 1/31 of the *Gas Daily* index. For weekends in the middle of the month, Friday trading is for flow on Saturday, Sunday and Monday, constituting one-tenth or 3/31 of the monthly *Gas Daily* index.

For the Texas team's manipulative scheme to work, they needed a steady and substantial supply of "new" gas – that is, gas that was not already in the HSC market.[93] The Texas team solved its supply problem by acquiring larger long, monthly gas positions at Katy. It also helped that in this period, Katy monthly gas was often cheaper than HSC monthly gas. Thus, the Texas team could flow their Katy gas to HSC, thereby reducing physical losses from selling uneconomically at HSC, while still having ample "new" gas to suppress the HSC market.[94]

2. The Texas Team Maximized the Impact of the "New" Katy Gas by Reducing SEGT's Delivery Obligations at HSC

SEGT's existing short, HSC physical position created an obligation to deliver gas to HSC on a daily basis. To maximize the impact of their "new" Katy gas on the HSC fixed-price market, the Texas team needed to reduce SEGT's overall short physical position at HSC. Otherwise, the Texas team would have to either buy gas at HSC every day to cover the short position and thereby exert upward price pressure on the *Gas Daily* index, or use some of their Katy supply to meet the short obligation at HSC. By flattening out most of the HSC short positions of the other SEGT traders by purchasing monthly HSC physical contracts for October and November, the Texas team could use more of their "new" Katy gas to suppress the HSC market.

B. The Texas Team Used BP's HPL Transport Capacity to Facilitate and Conceal the Manipulative Scheme

Part III confirmed that the Texas team had the authority to use BP's daily 200,000 MMBtu capacity to transport gas from Katy to HSC. This section shows that the Texas team's utilization of the HPL capacity during the investigative period was much higher than before or afterwards. From January 2008 through September 18, 2008, the Texas team used on average only thirty-four percent of BP's HPL capacity.[95] But from September 19, 2008 through November 30, 2008, the Texas team "packed" the HPL

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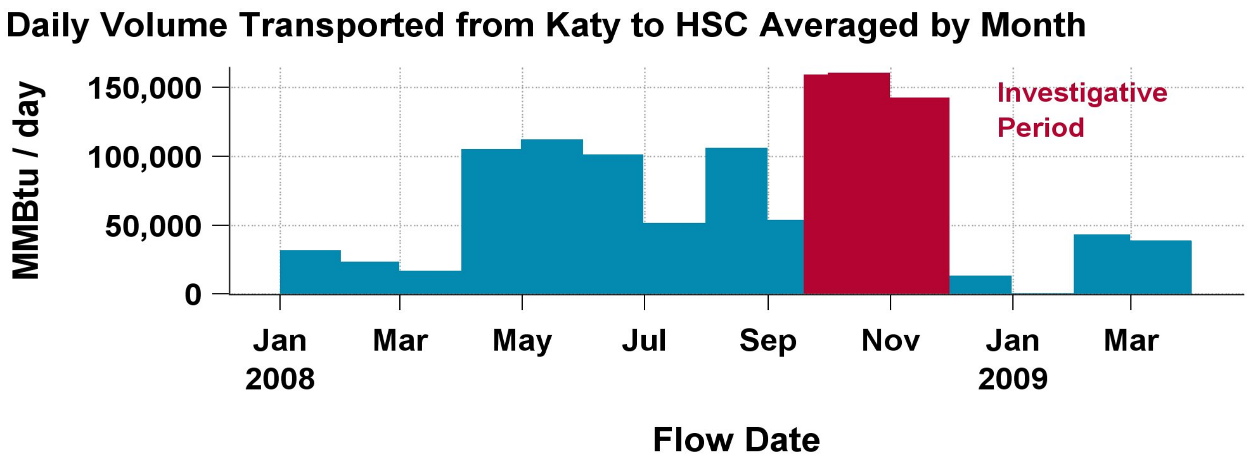
[93] "New" gas was necessary because buying and reselling gas at HSC would not be effective. Each buy would create upward pressure on the price, reducing any downward pressure a sale accomplished. While the Texas team could have created downward price pressure using gas they purchased at HSC if they re-sold that gas at greatly reduced prices, that strategy would have been much more costly and more obvious to BP Compliance, other market participants, and regulators.

[94] Comfort CFTC Dep. at 185-86 (noting that for October and November 2008, the Texas team was able to buy Katy gas at a reasonable discount).

[95] Because the manipulation began on or about September 18, 2008, the first flow date of the scheme was September 19, 2008.

pipeline – increasing its utilization to seventy-six percent on average per day. Later, once the Texas team no longer had a benefiting financial position, the Texas team decreased its utilization of the HPL capacity to eleven percent (December 2008 – March 2009).[96] *See* Figure 5.



September is divided into two periods: Sept. 1-18 and Sept. 19-30 (Data Source: Katy-Ship Excel Sheets ("Transport from Katy" cell).

Figure 5

Moreover, in the first eight and a half months of 2008, the Texas team used ninety-five percent or more of the HPL 200,000 MMBtus daily capacity on just three days. In contrast, in the two and a half months of the investigative period, the Texas team used ninety-five percent or more of the HPL capacity on fifteen days. In fact, on five of these fifteen days, with no apparent price incentive, the Texas team exceeded BP's HPL daily capacity, something that BP had never done going back to January 2007.

The HPL capacity was the only firm capacity that BP owned that supplied HSC,[97] so it was the obvious conduit for the Texas team to bring its "new" gas from Katy. Because this capacity was underutilized, the Texas team could count on it being available whenever they needed to move Katy gas to HSC. Using the existing HPL capacity also

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[96] The Texas team's seventy-six percent HPL utilization rate in the investigative period was also a historical anomaly. From November 2007 through August 2008 and again from December 2008 through March 2009 when the existing HPL contract ended, there were no months when the monthly utilization was over seventy-five percent. More precisely, from November 2007 through August 2008 and from December 2008 through March 2009, the average monthly utilization was about twenty-nine percent.

[97] Luskie CFTC Dep. at 157:2-22.

enabled the Texas team traders to conceal the manipulation because they did not need to pay for replacement shipping or obtain new transportation contracts that would have required review and approval. Thus, the Texas team's ability to use BP's HPL capacity was critical to both facilitating and masking the manipulative scheme.

C. Significant Changes in the Direction, Volume, and Timing of the Texas Team Sales of Physical Gas at HSC Provide Evidence of Market Manipulation

The Texas team's fixed-price trading behavior at HSC changed during the investigative period. Specifically, the daily trading data shows three significant changes in the Texas team's daily trading behavior during the investigative period: (1) the Texas team traders became net sellers of fixed-price gas at HSC; (2) they increased their sales volume of fixed-price gas at HSC; and (3) they began a pattern of early fixed-price trading. Each of these changes increased the Texas team's ability to influence the HSC *Gas Daily* index.

1. <u>The Texas Team Became Net Sellers of Physical Gas at HSC</u>

Before the investigative period, the Texas team was both a buyer and a seller of next-day fixed-price gas at HSC. In the investigative period, the Texas team changed their daily trading behavior and became exclusively a net-seller of next-day, fixed-price gas at HSC for all but one day.

There were fifty-one trading days from June 30, 2008 through September 10, 2008.[98] In this pre-investigative period, the Texas team was a net buyer of fixed-price gas at HSC on thirty-nine of these days and a net seller of fixed-price gas on twelve days. In contrast, for the forty-nine trade dates from September 18, 2008 through November 25, 2008,[99] the Texas team traders were net sellers of fixed-price gas at HSC for all but one day. This run of net selling for forty-eight of forty-nine trading days also stands in sharp contrast to the Texas team's behavior after the investigative period, where the Texas team

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[98] Staff chose the two and a half month period before the investigative period – July through early September 2008 – as the primary comparative period. June 30, 2008 was the first trade date for July 2008 because gas traded that day flowed on July 1, 2008. To be conservative, staff excluded trade dates September 11-17, 2008 from this analysis because HSC volume on ICE dropped below 350,000 MMBtus on these days due to the impact of Hurricane Ike. The Texas team, however, was also a net seller at HSC on September 15, 16, and 17, 2008.

[99] November 25, 2008 was the last trade date for the month because the markets were closed for the Thanksgiving holiday and the weekend.

was a net seller of fixed-price gas at HSC on just two out of twenty trading days in December 2008.

The Texas team's sales within September 2008 also demonstrated the team's new trading pattern. For the first eight trading days of September 2008, the Texas team was a net seller of fixed-price gas at HSC on just one day. However, starting September 18, 2008, the Texas team became a net seller of fixed-price gas at HSC for the remaining eight trading days of the month.[100] *See* Figure 6.

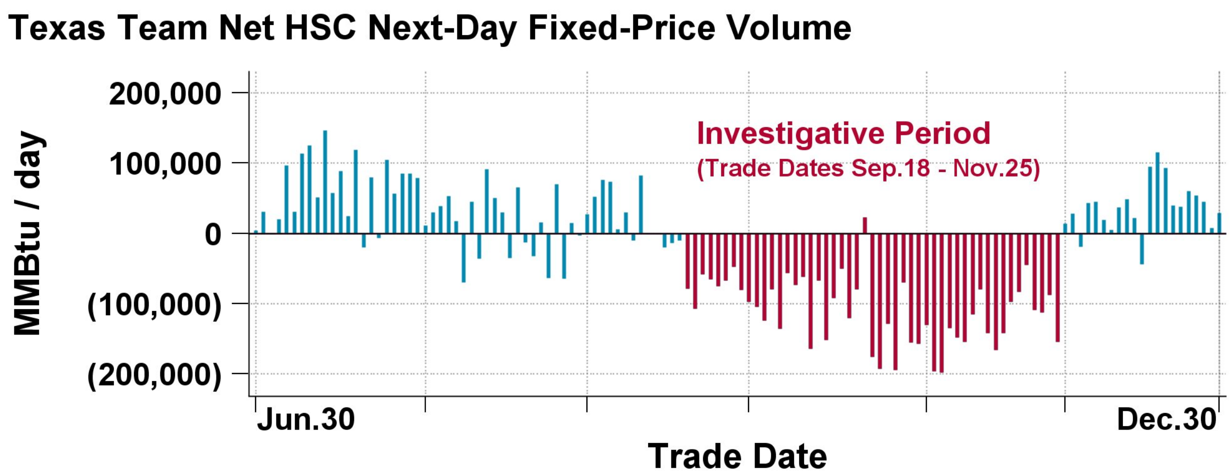


Figure 6

2. <u>The Texas Team's Increased Sales Concentration of Next-day, Fixed-Price Sales at HSC</u>

The Texas team increased their sales volume of next-day, fixed-price gas at HSC during the investigative period. ICE data shows that the Texas team sold about four and a half times more next-day, fixed-price gas at HSC in the investigative period than they had from July 2008 through early September 2008.[101] Because of this increased volume,

[100] The Texas team's net selling run during the investigative period is also inconsistent with BP's practice over a longer timeframe. From Comfort's starting date in December 2007 through September 10, 2008, the Texas team was a net seller of fixed-price gas at HSC on only thirty-two percent of trading days and was never a net seller at HSC for longer than ten consecutive days.

[101] In December 2008, the Texas team returned to their pre-investigative period sales volume levels. Potential seasonal issues do not explain the Texas team's increased sales volume at HSC in the investigative period. Staff examined ICE data for a similar period in 2007 and found that Texas team sales of fixed-price gas were seventy-three percent lower than sales volume at HSC in the investigative period.

the Texas team was able to enlarge their HSC fixed-price market sales concentration in the investigative period.[102] From trade date September 18, 2008 through the end of November 2008, the Texas team's sales concentration averaged twenty-seven percent of the daily HSC fixed-price market. In comparison, the Texas team's sales concentration for the HSC fixed-price market on ICE was just four percent for the two months that proceeded the investigative period and again just four percent in December 2008.[103]

While some of the increase in sales concentration was the result of having a larger net long physical position at Katy and HSC, the Texas team was able to increase their sales concentration by selling more of their Katy gas at HSC and more of their overall gas position at HSC-fixed price (rather than at fixed-price at Katy or at index at HSC). In the investigative period, the Texas team sold sixty-six percent of its Katy gas at HSC compared to thirty-two percent from July 1, 2008 through September 11, 2008 and twenty-two percent during December 2008.

In addition, before the investigative period, the Texas team sold just twenty-three percent of its monthly gas position at fixed-price and liquidated the rest through a combination of index sales or other pricing mechanisms.[104] But from September 18, 2008 through the end of November 2008, the Texas team's next-day, fixed-price sales at HSC exceeded sixty-four percent of its physical sales volume. In December 2008, the Texas team reduced the percentage of fixed-price sales at HSC to fifteen percent.

The Texas team's increased HSC fixed-price sales concentration directly and significantly increased the Texas team's contribution to the *Gas Daily* index because only fixed-price trades are used to calculate the *Gas Daily* index.[105] Staff has discovered no price incentives – and BP has offered no reason – for why the Texas team chose to trade more of their physical position at HSC fixed-priced. Staff concludes that these changes

[102] Sales concentration is calculated by dividing the Texas team's HSC sales volume by the total HSC volume on ICE.

[103] Trade dates September 11-17, 2008 again were excluded because of Hurricane Ike's impact on volume at HSC.

[104] These figures were calculated by dividing all ICE-traded Texas team HSC next-day, fixed-price sales by all HSC and Katy next-day transactions (including fixed-price and *Gas Daily* deals).

[105] Greater fixed-price market share translates directly into a greater impact on the *Gas Daily* daily index because the *Gas Daily* daily (GDD) is a volume-weighted average of all fixed-price sales throughout the trading day that are reported to Platts. As noted, each day's GDD constitutes 1/30 or 1/31 of the monthly *Gas Daily* index.

in the Texas team's HSC fixed-price trading are evidence of the team's intent to exert a greater influence on the HSC *Gas Daily* index to benefit their financial position.

3. The Texas Team's Early, Heavy Selling at HSC

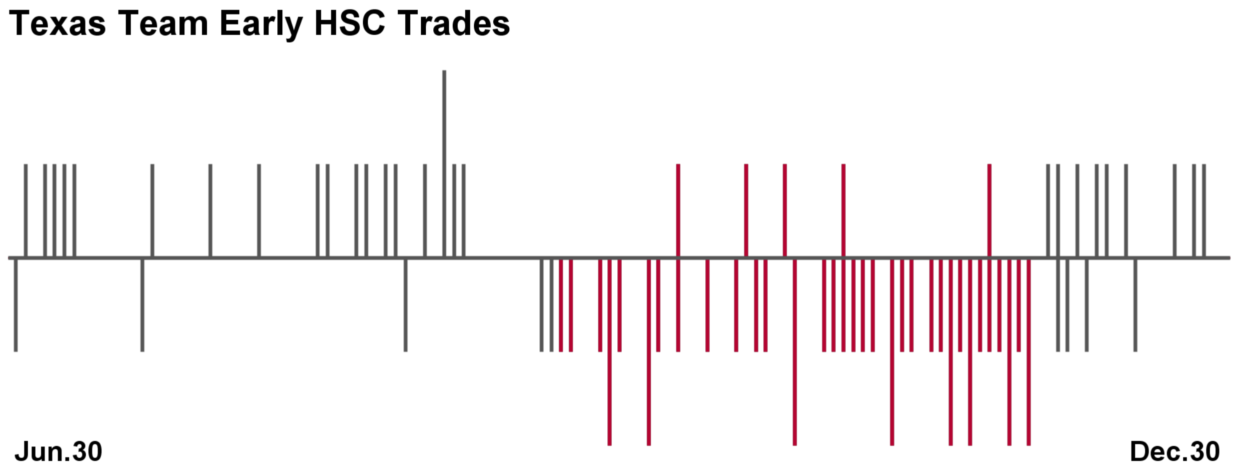
The Texas team traders also engaged in a pattern of early and heavy fixed-price sales that helped frame the early HSC market and thereby amplify their efforts to suppress the HSC *Gas Daily* index. This section presents data that the Texas team became a more active seller at or near the start of trading each day and explains why the Texas team's shift to heavy early trading aided the manipulative scheme.

Before and after the investigative period, the Texas team traders were sometimes involved in the first trade of the day at HSC as a buyer or as a seller. For example, from June 30, 2008 through September 10, 2008, the Texas team was the seller in the first HSC trade on two of fifty-one trading days and the buyer on twelve of fifty-one trading days. Similarly, after the investigative period in December 2008, the Texas team was the seller in the first trade on two of twenty-one trading days and the buyer on four of twenty-one trading days. In contrast, during the investigative period, the Texas team was the seller in the first HSC trade twenty of forty-nine trading days and the buyer only three of forty-nine trading days.[106]

Continuing this analysis into the first three trades of the day further emphasizes this pattern. In the pre-investigative period of June 30, 2008 through September 10, 2008, the Texas team was a seller in one or more of the first three trades on just three of fifty-one trading days but a buyer in one or more of the first three trades in eighteen of fifty-one trading days. Once the investigative period began, however, the Texas team was a seller in at least one of the first three trades on thirty-three of forty-nine trading days from September 18, 2008 through November 30, 2008. In November alone, the Texas team was one of the first three sellers on eighty-three percent of the trading days (fifteen of eighteen trading days).

Lastly, staff identified instances where the Texas team was the seller in all of the first three HSC trades of the day. In the pre- and post-manipulation periods (June 30-September 10, 2008 and December 2008, respectively) the Texas team was not the seller in all of the first three trades even once. During the investigative period, however, the Texas team was the seller in the first three transactions at HSC on eight separate occasions. In contrast, the Texas team was never the buyer in the first three trades at HSC during the investigative period. *See* Figure 7.

[106] In November 2008, the Texas team was the seller in the HSC first trade on fifty percent of the trading days in the month.



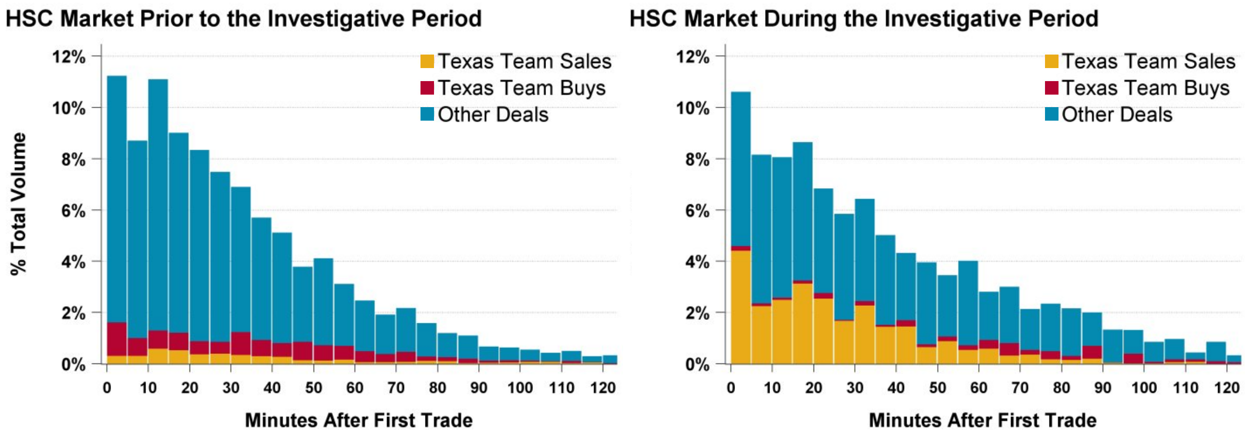
This graph depicts trade dates on which one of the first three transactions was a Texas team buy (upward bar) or a Texas team sale (downward bar). A long bar indicates that all of the first three transactions on that day were made by the Texas team. The investigative period is in red.

Figure 7

The shift to trading at or near the opening of the HSC market can also be seen by examining the Texas team's sales volume in the first five minutes of trading before and during the manipulation. Before and during the investigative period, the first five minutes was the most heavily traded interval for all participants in the HSC market.[107] From December 31, 2007 through September 10, 2008, the Texas team's sales concentration in the first five minutes of trading averaged just seven percent. That concentration, however, increased to forty-eight percent during the investigative period.[108] Additionally, the graph below depicts that the Texas team's sales made up a substantially larger portion of the early HSC market than they had during the pre-investigative period. *See* Figure 8.

[107] ICE next-day, fixed-price gas trading begins when the first trade is consummated. In 2008, physical gas trading at HSC typically began between 8:00 and 8:30 a.m. ET. On most days, there was consistent trading volume between 8:30 a.m. and 9:30 a.m. Trading would typically slow by 10:00 a.m. and was usually finished by 11:00 a.m.

[108] In addition to the Texas team's increased early sales volume relative to the total market volume, the Texas team also sold a higher percentage of its *own* volume earlier (relative to the time after the first trade) during the investigative period. Before the investigative period, the Texas team sold seven percent of its total sales volume in the first five minutes. During the investigative period, the Texas team shifted more of its selling earlier, such that the traders sold seventeen percent of their total sales volume in the first five minutes, more than doubling their percentage in the earliest interval.



HSC transactions are grouped in five-minute intervals (as minutes after the first trade) along the horizontal axes. The vertical axes express the percent of total volume transacted in each five-minute interval.

Figure 8

The Texas team used early selling to frame the market because although the team was able to increase its sales concentration by selling more fixed-price gas at HSC, there were physical and financial constraints on how much physical gas the team could transport into the HSC fixed-price market each day. First, the Texas team's monthly positions at Katy and HSC determined the quantity of gas the traders had each day to sell out at HSC. Second, BP's daily firm capacity on HPL of 200,000 MMBtus created an upper limit on how much volume the Texas team could ship to HSC from Katy without incurring additional cost and scrutiny.

Accordingly, to obtain the greatest price impact from their HSC sales, the Texas team traders engaged in a strategy of heavy, early selling. Early trading can have an amplified effect on the market because traders watch the developing volume-weighted average price (VWAP) and recently transacted prices to make trading decisions.[109] The

[109] Simmons Dep. at 109:13-19 (BP compliance analyst for the Texas team recognized that trading early in the morning could help a trader influence an index because it "could provide signals to direction and momentum"). Luskie testified that he and other traders look to current bid and offer data, the previous transaction price, and the developing VWAP to help make intra-day trading decisions. Luskie Dep. Vol. II at 381:10-382:10. Therefore, he agreed that trading early is more likely to cause traders to reassess their view than trading later. *Id*. at 384:17-20. Moreover, in the gas markets, because significant quantities of physical gas trade based on the GDD, the developing VWAP is of interest to those traders who have positions that will settle based on the GDD price. Thus, a trader who successfully "frames" or "marks" a physical gas market

early VWAP is especially important to traders in a fixed-price gas market because physical traders have to be flat by the end of the day. Thus, traders with a short position at a hub who see early, heavy volume at attractive prices tend to feel pressure to buy some of that volume to ensure that they can cover their short position for the day at a good price. While market fundamentals may move the price up or down after an early seller has sold his volume for the day, selling more volume early ensures that the seller has both a direct contribution towards the final GDD index as well as an indirect influence on all contemporaneous and succeeding transactions.[110]

In the investigative period, the Texas team's heavy and early selling ensured that the Texas team was often the dominant contributor to HSC's early VWAP. By selling heavily and early on many days, the Texas team traders maximized the impact of their "new" Katy gas on the HSC market – getting the most "bang" out of their trading volume by having an out-sized influence on the other market participants' perception of the early fixed-price HSC market. Thus, an effort to frame the early HSC market explains the Texas team's shift to heavy, early trading in the investigative period.[111]

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early can influence the GDD without having to sell at prices significantly outside the prevailing market.

[110] The text above captures the concept of "marking the open" also known as "framing the market." *See* Michael J. Barclay & Terrance Hendershott, *Price Discovery and Trading After Hours*, 16 THE REVIEW OF FINANCIAL STUDIES 1041 (Winter 2000) (presenting research on pre-open trading in equity markets that supports the general principle that early trades contain more price discovery information than trades later in the daily trading session); *see also Market Regulation Committee v. Morgan Stanley & Co.*, 2000 NASD Discip. LEXIS 1, *60, *88 n.37 (2000); *Department of Enforcement v. Brokaw*, 2010 FINRA Discip. LEXIS 34, * 30 n.28 (2010); NASD Sanction Guidelines (2011 ed.) at 56, *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf.

[111] While early selling at HSC on a particular day might be consistent with a trader's view that intra-day prices would decline, there is no evidence that the Texas team traders consistently held this view nor do HSC price movements support this explanation for the pattern of early, heavy trading. For example, Luskie traded physical gas in October on three days when Comfort was out. On all three days he sold between forty to sixty percent of the Texas team's net long gas position at HSC before Katy trading began. He testified that, in retrospect, he sold too early on these days and he could not provide a clear good reason for why he sold "a lot of gas at Ship Channel before Katy opened." Luskie Dep. Vol. I at 227:7-13; 228:2-3; 271:3-16. Luskie also recognized that after selling too early at HSC on October 16, 2008 and losing money, he traded the same way at HSC the very next day. Luskie Dep. Vol. I at 245:2-9.

D. The Texas Team's Physical Gas Trading at HSC was Inconsistent with their Stated Arbitrage Strategy

This section explains why the Texas team's trading pattern in the investigative period – especially selling large volumes of gas at HSC before the first Katy trade – cannot be reconciled with their purported strategy for using the HPL capacity.

1. The Texas Team's Stated Arbitrage Strategy

BP's daily 200,000 MMBtu capacity on HPL gave the Texas team the ability to arbitrage price differences between Katy and HSC in the next-day, fixed-price market. Comfort testified, "the flow from Katy to [HSC] would occur when the spread between the two is contemplated to allow for transport over and above [the cost of transport]."[112] Comfort also testified that in most of 2008, the Texas team held long positions in physical gas at Katy and that he liked to own physical gas at Katy because it gave him the "optionality"[113] to either "trade the Katy molecules at Katy and buy Ship molecules at Ship Channel"[114] or use the HPL transport to move the Katy supply to HSC if "prices are such that it makes sense to transport."[115]

The centrality of the arbitrage strategy to the Texas team's use of the HPL capacity was memorialized in a November 20, 2008 memo ("the HPL Transport memo") from Comfort to his supervisor Kevin Bass.[116] In the section of the HPL Transport memo

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[112] Comfort CFTC Dep. at 175:20-176:1. *See also* Luskie CFTC Dep. at 156:1-15 (stating that "there's a number of factors, but generally, it's just transport economics. If -- if Ship is -- is higher than Katy by the -- by more than the transport differential, we ship").

[113] Comfort Dep. Vol. III at 544:11-14.

[114] *Id*. at 544:22-23.

[115] *Id*. at 544:15-16.

[116] This memo was written after the Luskie recorded call was disclosed to BP Compliance and when Comfort and Bass knew the Texas team's use of the HPL transport was under internal investigation. Comfort appears to have drafted the memo (perhaps with input from other members of the Texas team) pursuant to a request from management that was communicated through Bass. Comfort Dep. Vol. II at 277:2-278:5. BP provided three versions of the HPL Transport memo – a draft at 11:32 a.m. from Comfort to Bass, a revised version from Bass circulated to the Texas team at 12:52 p.m., and another version from Comfort to Bass at 1:16 p.m. Staff focuses on the first version because it likely represents the initial thoughts of Comfort – although he claimed not to

titled "Arbitrage Strategy," Comfort stated that for "cash trading" (synonymous with next-day, fixed-price trading) he would:

a. Purchase Katy area gas volumes. Deliver to HSC Pool. Sell HSC Pool volumes. This strategy entails purchasing Katy volumes at prices sufficiently below HSC Pool prices to both cover variable cost and provide a profit margin.

b. As prices change throughout the cash session, if the opportunity arises where Katy prices move toward, inside or over variable cost, sell Katy Area volumes, buy HSC Pool volumes.

The HPL Transport memo and deposition testimony also establish that the Texas team traders understood that the cost of transporting gas from Katy to HSC to be approximately $0.013 in this period.[117] Thus, to faithfully implement the stated arbitrage strategy, the Texas team should have sold and transported its Katy gas to HSC only when HSC prices exceeded Katy area prices by $0.013 or more. Otherwise, this strategy dictated that they should have sought to sell their daily Katy gas at Katy.[118]

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remember with certainty that he drafted some or all of it. Comfort Dep. Vol. II at 278:2-282:8. The HPL Transport memo begins with an outline of the purposes of the HPL Transport with "Cash Trading" listed first, and delivering gas to BP customers and enhancing the Texas 'web' of assets second and third. *See* Luskie Dep. Vol. I at 151:21-23 (the HPL transport was used primarily for cash trading in the investigative period). After listing costs of the HPL Transport (the Demand Charge and Variable Charges), the memo lays out the "Arbitrage Strategy." Below that is a section titled "Daily Cash Decisions" (the final draft calls these "Factors in Cash").

[117] From August 2008 through November 2008, the variable cost to transport physical gas between Katy and HSC on HPL averaged $0.013 per MMBtu. Katy Excel Spread Sheet at BP-L 00147472; BP-L 00146151; BP-L 00146158; BP-L 00146144; and BPL F2 00093844.

[118] Under "Daily Cash Decisions," Comfort listed four factors: (1) View on fundamentals; (2) Determine the relative value of the Katy area/HSC Pool cash price; (3) Assess customer requirements and determine how to manage positions; and (4) Trade within limits of the HPL Agreement. In deposition testimony, Comfort asserted that while in retrospect certain trades may appear to have been "uneconomic" under the arbitrage strategy, these trades were legitimately motivated by the Daily Cash Decision factors, most centrally, his view of daily market fundamentals. Comfort Dep. Vol. IV at 785:1–790:3. If his daily market view turned out to be wrong, that led to transport and index losses. *Id*. For example, Comfort stated that he might buy gas early at Katy based on a view that the market would rise. *Id*. If prices instead dropped at both Katy and HSC

2. The Texas Team's Increase in HSC Sales before the First Katy Trade was Inconsistent with the Stated Arbitrage Strategy

Before the investigative period, the Texas team generally waited for the first trade at Katy before selling in large volume at HSC. For example, from January 1, 2008 through September 11, 2008, the Texas team sold just twenty percent of its volume at HSC before the first Katy trade. In contrast, during the investigative period, the Texas team sold more than a third of its volume (thirty-five percent) before the first Katy trade. In December 2008, once the manipulation ended, the Texas team's percentage of sales at HSC before the first Katy trade reverted to their previous, lower volume – constituting just ten percent of their sales volume.

Because the arbitrage strategy sought to exploit small differentials between HSC and Katy prices, waiting for the first Katy transaction before engaging in heavy sales at HSC made sense.[119] These markets generally traded within pennies of each other and successful execution of the arbitrage strategy required that both markets be open so that the traders could see real prices and assess actionable arbitrage opportunities as they arose.[120] Heavy selling at HSC before Katy opened was even riskier for the Texas team

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and the HSC bid price provided the best mitigation opportunity, he would hit that bid with the resulting sale appearing to be uneconomic under the arbitrage strategy. *Id*. Comfort's attempt to justify his repeated uneconomic selling at HSC, however, is not credible. First, his explanation is not consistent with the data, which reflects a consistent pattern of uneconomic selling early and heavily at HSC before Katy opened rather than a variable daily market view that was occasionally wrong. Moreover, the pattern of heavy, early selling continued despite daily PnL figures that reflected that this strategy was ill-chosen. Second, this Part also shows that at the same time the Texas team traders were selling uneconomically at HSC, they were quite successful selling at Katy. Third, Comfort did not memorialize his daily views on the HSC market and he claims to have no memory of any specific day. Thus, unlike the arbitrage strategy, which can be subjected to empirical testing, Comfort's explanation for repeated uneconomic selling at HSC relies solely on his assertions.

[119] In 2008, HSC typically began trading between 8:00 and 8:30 a.m. (ET). Katy trading typically, but not always, began after HSC, although the number of minutes varied.

[120] Luskie admitted that without an active Katy market, he could "guess or [have] some idea" but would not know what he could get for his Katy gas at Katy. Luskie Dep. Vol. I at 189:8-16. Nevertheless, BP has argued that the traders could obtain pricing information "from a variety of sources" and therefore gauge market price levels at Katy before the first Katy trade, including from "resting" bids and offers. BP Response to Preliminary Conclusions Regarding FERC's Non-Public Investigation of BP America

because the Texas team's gas was at Katy and could be sold there without paying the $0.013 per MMBtu transportation cost to HSC. Selling at HSC before the first trade at Katy meant that the Texas team traders not only had to predict that HSC would be higher than Katy that day, but that HSC prices would be at least $0.013 higher for their early sales at HSC to have been economic under the arbitrage strategy.

No observable early price patterns at Katy and HSC justified selling, in heavy volumes, gas at HSC before the first Katy trade in the investigative period, yet that is what the Texas team did. BP claims that the Texas team had to sell in heavy volume at HSC before Katy opened because as a large net seller in the investigative period, the Texas team needed HSC's greater liquidity to be sure they could sell out their Katy long position each day.[121] BP's argument that pre-Katy selling at HSC was necessary for liquidity cannot be reconciled with the traders' testimony that both points were liquid or with Comfort's testimony that establishing a long position at Katy gave the Texas team the "optionality" of selling at Katy or HSC.[122] The Texas team's actions in October also belie this liquidity argument. In late October, the Texas team chose to increase their November Katy long position to the same level as they had in October. By this point in time, the Texas team would have known if this quantity of gas was too large to successfully execute the arbitrage strategy. Therefore, staff concludes that the Texas

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Inc., BP Corporation North America Inc., BP American Production Company, BP Energy Company and BP Products North America Inc. December 23, 2010 (BP's Response to Preliminary Findings Letter). "Resting" bids and offers – bids and offers with no executed trades – indicate that market participations are unwilling to transact. Thus, the existence of a "resting spread" (i.e., the spread between the resting bids and offers) before the first Katy trade generally would not have given the Texas team traders sufficient information to predict opening prices at Katy to within the pennies necessary to make heavy pre-Katy selling at HSC reasonable under the arbitrage strategy. Nor has BP identified the sources that would have routinely provided the Texas team with sufficiently specific pre-open Katy pricing information.

[121] BP's Response to Preliminary Findings Letter at 18. BP argues that HSC had greater liquidity than Katy because (1) HSC trades in this period had a larger volume per transaction and (2) the HSC bid/offer spread was narrower than Katy's bid/offer spread. *Id*. at 18-19. As illustrated by the chart in Appendix C, Katy was more liquid in this period than HSC in terms of volume, number of buyers, number of sellers, and period of active trading. BP's claim that HSC was more liquid also ignores the fact that one-third of the pre-Katy liquidity at HSC was made up of Texas team sales.

[122] Comfort Dep. Vol. III at 544:11-14; Comfort CFTC Dep. at 192:9-193:4; *see also* Barnhart Dep. at 123:22-25; Luskie Dep. Vol. I at 229:3-6 (stating that his Katy position on October 16, 2008 was not unmanageably long).

team sold large volumes of gas at HSC before the first Katy trade in October, and throughout the investigative period, in order to frame the early HSC market as part of the manipulation – and not for liquidity reasons.

3. The Texas Team's Sales at HSC were Uneconomic Under the Stated Arbitrage Strategy

This section demonstrates that the Texas team's trading at HSC in the investigative period was uneconomic under the HPL Transport memo's arbitrage strategy. Staff employed several methodologies – using end-of-day and intra-day prices as well as bid and offer data from HSC and Katy – to analyze the Texas team's selling at HSC. The Texas team traders regularly passed up higher priced opportunities to sell its physical gas and disregarded consistent market signals that their new pattern of heavy, early selling at HSC was less economic. Yet, instead of reacting to these signals and selling more of their Katy gas at Katy or selling their gas more ratably at HSC throughout the trading session, the Texas team traders continued their pattern of uneconomic trading throughout the investigative period. Their persistence in pursuing an uneconomic trading pattern, along with the other evidence supporting the existence of a manipulative scheme, demonstrates that the Texas team traders had an ulterior and unlawful intent.

a. End-of-Day Prices Show that the Texas Team's Sales at HSC were not Economically Justified under the Arbitrage Strategy

The Texas team traders had pricing information at the end of each trading day that informed them that their early, heavy HSC sales were consistently below the HSC and Katy daily averages. This section pays particular attention to the Texas team's trading in first three weeks of October 2008, just before the traders increased their November Katy and HSC monthly long physical positions.

i. The Texas Team Consistently Sold Gas at HSC Below HSC Daily Prices

From October 1, 2008 through October 24, 2008, the Texas team had about twenty-three contracts of Katy gas, and they sold, on average, fourteen of these contracts at HSC at fixed-price each day. During this three-week period, the VWAP of the Texas team's sales at HSC was below the HSC Gas Daily daily (GDD) on seventy-eight percent of the trading days (for an average loss of $0.012 per MMBtu).

The Texas team's consistent failure to match or exceed each day's HSC GDD in this period is notable. The bid/offer spread gives a patient seller, who sells by having his higher offer lifted, a better price than the anxious seller who hits the lower bid. A seller who sells at least fifty percent of the time by waiting to have his offers lifted, and who sells ratably throughout the day, theoretically should be able to match the index.

Moreover, because the Texas team sales constituted twenty-three percent of the HSC fixed-price market on ICE during these three weeks, the odds of matching the index should have been even better.

Thus, in the first three weeks of October, the Texas team traders were not acting like classic arbitrage sellers – picking and choosing to sell as opportunities arose. Rather, in these weeks, they were hitting bids more often than waiting to have their offers lifted – indicating a more aggressive and anxious selling profile.[123] By selling a third of their volume early, they missed higher priced opportunities on days when the HSC price rose later in the trading session. Yet, even after the Texas team's weak performance against the HSC GDD in the first three weeks of October, the Texas team decided to increase their long Katy and HSC positions in monthly physical for November 2008.[124]

In November 2008, the Texas team continued to sell more of its Katy gas at fixed-price at HSC and to sell more of it early. Unsurprisingly, the Texas team's sales performance at HSC in November was again poor. During November, the Texas team's sales at HSC were $0.016 per MMBtu below the HSC *Gas Daily* index.

Therefore, staff concludes that the Texas team's decision to persist in a pattern of selling at HSC that failed to meet or exceed the HSC *Gas Daily* index for two straight months is evidence that the Texas team traders consciously chose not to follow their stated arbitrage policy at HSC in these months.[125]

ii. The Texas Team Consistently Sold Gas at HSC Below Katy Daily Prices

Under the stated arbitrage strategy, the Texas team sought to sell gas at HSC when the HSC price (minus the cost of transport) was higher than the contemporaneous Katy price. Therefore, comparison of the Texas team's HSC sales VWAPs (with an

[123] In this period, the Texas team sold 2.1 million MMBtus by hitting bids versus 1.3 million MMBtus by having their offers lifted.

[124] At the beginning of October, the Texas team had a long November Katy position of just two contracts. During October bid week, they increased the November Katy long position to about twenty-two contracts and reduced SEGT's HSC position to almost flat by buying eight HSC contracts.

[125] While the Texas team's October Katy monthly gas position created a daily receipt obligation, if the position was proving unmanageable in the daily market, the Texas team could have sold some or all of their Katy gas any number of ways including: a BOM trade, or sales at index at HSC, or at index, or in the fixed-price Katy market.

adjustment for transport costs) against the Katy GDD provided the Texas team with additional daily feedback on whether their new trading pattern was successful.

During the investigative period, the Katy GDD was consistently higher than the VWAP of the Texas team's HSC sales, providing the Texas team with a clear indicator that their heavy and earlier selling at HSC was failing to capture higher priced opportunities at Katy. For example, in October 2008, the VWAP of the Texas team's sales at HSC (minus the cost of transport) was below the Katy GDD on eighteen out of twenty-three trading days. Yet the Texas team traders came back, day after day, to trade early and in high volume at HSC with the same results. As a result, for the month of October, the Texas team sold gas at HSC at a $0.02 per MMBtu deficit compared to Katy's GDD prices (plus the cost of transport).[126]

In contrast, before the investigative period, the Texas team had been able to sell more economically at HSC. For example, from July 2008 through September 10, 2008, the Texas team's sales at HSC beat the Katy GDD (factoring in transport costs) by about $0.02 per MMBtu. This comparative evidence further supports staff's conclusion that the Texas team's disregard of the arbitrage strategy at HSC in the investigative period was intentional.

b. The Texas Team's Sales at HSC Before the First Katy Trade Were Uneconomic Under the Stated Arbitrage Strategy

To determine whether the Texas team's repeated selling of one-third of its daily volume at HSC before the first Katy trade was economically justified, staff used the same intra-day HSC and Katy trade prices that the Texas team traders had on their computer monitors as the trading day unfolded. For each day in October and November 2008, staff compared the VWAP of the Texas team's sales at HSC before the first Katy trade against the execution price of the first ICE trade at Katy.[127] The results are striking. After including transport costs, the VWAP of the Texas team's early sales at HSC were lower than the first Katy trade on twenty-seven out of thirty-eight days in October and

[126] In November, the Texas team's HSC sales failed to beat the Katy GDD (factoring in transport costs) on nine out of eighteen trading days for a deficit of about $0.005 per MMBtu. The improvement against the Katy GDD may have been market related or the result of the Texas team easing up on the manipulative scheme after the November 5, 2008 recorded call was reported to BP's Compliance department and regulators.

[127] While the Texas team may have had the option on some days to make bilateral trades at Katy through voice brokers before the first ICE trade at Katy, staff used only ICE trades in this analysis because BP did not time-stamp voice broker trades.

November.[128] In volume, seventy-three percent of the Texas team's pre-Katy open sales at HSC (minus the cost of transport) were lower than the first Katy trade price.

The first Katy trade price of the day provided the Texas team traders with an unambiguous benchmark against which to measure whether their decision to sell early at HSC had been economic. While the Texas team may not have been able to sell all their early HSC sales volume at Katy in the first trade of the day, the opening price should have indicated to the Texas team that they were routinely passing up better opening price options at Katy for at least some of their Katy gas. Yet, throughout October and November, the Texas team traders continued to sell heavily at HSC without waiting for Katy to start trading. This failure to adjust trading behavior in the face of clear signals that their new pattern of selling more gas at HSC before the first trade at Katy was generating losses is strong evidence that the Texas team traders were selling at HSC to further the manipulation rather than to execute the stated arbitrage strategy.[129]

c. Bid and Offer Data also shows that the Texas Team's Sales at HSC were Uneconomic under the Arbitrage Strategy

Staff then used intra-day bid and offer data to evaluate the Texas team's fidelity to their stated arbitrage strategy in their moment-to-moment decisions to trade at Katy or at HSC during the investigation period. Examination of that data reveals the Texas team traders generally sold at Katy when it was economic while their HSC sales reflect an indifference to the economics of the arbitrage strategy.

Traders seeking arbitrage opportunities between two locations will continually look at the current bids and offers to determine if there is an actionable opportunity. In this case, staff evaluated the Texas team's fidelity to their arbitrage strategy by comparing each Texas team sale at Katy and HSC against the best bid and best offer at the other location at the time of the transaction.

Staff first determined whether the Texas team made a sale by hitting a bid or by having their offer lifted. For example, if a HSC sale was the result of a lifted offer, staff compared this price to the best concurrent offer at Katy. Similarly, if the Texas team hit a bid at HSC, staff used the Katy bid at the time. Matching bids to bids and offers to

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[128] The number of trading days in this analysis is less than the number of trading days in the investigative period because Katy traded before HSC on a few days.

[129] Staff also determined that the Texas team took a greater loss on its pre-Katy sales at HSC in the investigative period than from July 1, 2008 through September 10, 2008 whether measured as total dollar lost (about $140,000 vs. $9,000), or per MMBtu ($0.039 vs. $0.015).

offers is the correct methodology because the Texas team had the ability to sell either way at both locations. Matching offers to offers and bids to bids also best captures the intent of the Texas team trader who made the sale.[130]

Analysis of the Texas team's fidelity to the arbitrage strategy by looking at bid and offer data presented one methodological challenge: over one third of the Texas team's HSC sales took place before the first Katy trade. Therefore, there are no truly comparable Katy bids and offers for those trades because "resting" bids and offers are indicative of an inactive market. This Part, however, has already shown that the Texas team's high volume selling before the first Katy trade was inconsistent with its arbitrage strategy. Therefore, for purposes of determining which Texas team sales were "uneconomic" under a bid/bid and offer/offer analysis, staff excluded the HSC sales (about one-third of the daily HSC volume) that occurred before the first Katy trade. Excluding the pre-Katy sales at HSC gives the benefit of the doubt to BP because the absence of an active Katy market would argue in favor of presuming that all the early HSC sales were uneconomic.[131]

[130] Hitting a bid indicates a desire to consummate a sale immediately whereas waiting to have an offer lifted indicates a seller willing to wait for a price taker. While contesting that the Texas team operated "solely" under the arbitrage strategy, Luskie agreed that to analyze just the arbitrage strategy, it would be a fair methodology to compare Texas team hit bids with the contemporaneous Katy bid and the Texas team's offers lifted at HSC with the contemporaneous Katy offer. Luskie Dep. Vol. II at 467:4-468:18.

[131] BP's experts at NERA Economic Consulting (NERA) analyzed the Texas team's trades using bid and offer data but their analysis is flawed. First, NERA separately compared the Texas team's HSC sales with bids at two Katy points, Oasis and Enstor. Because the Texas team had gas at both points, staff's analysis combines the two, thereby limiting the times at which there was no contemporaneous bids or offers to the HSC sale. NERA analysis also compares contemporaneous Katy bids against the Texas team sales at HSC. BP argues that the Katy bid is the price at which the Texas team could have sold at Katy. Under this methodology, NERA indicates that eighty-two percent of the Texas team's HSC sales were economic. NERA's analysis ignores the fact that the Texas team could and did sell by posting offers at Katy and made sales at HSC by having their offers lifted. Thus, NERA's analysis compares apples to oranges. Because an offer is always higher than a contemporaneous bid, NERA's methodology makes the Katy market appear to be lower priced than it actually was. This downward skewing is exacerbated by the fact that NERA uses "resting" Katy bids. "Resting" bids are by definition, lower than where Katy sellers were willing to sell before trading began.

Using this methodology, staff found that the Texas team traders, when they chose to sell at Katy, were able to sell there economically approximately eighty percent of the time – meaning that they sold at Katy rather than HSC when the bid/offer spread (plus the cost of transport) showed that it was more profitable to sell at Katy. Using the same analysis, however, the Texas team's traders appeared largely indifferent to the profit motive when choosing to sell at HSC in the investigative period. For the Texas team sales at HSC after the first trade at Katy, the Texas team sold economically only about fifty percent of the time.

This side-by-side comparison of the economics of the Texas team's trading at Katy (eighty percent) vs. HSC (fifty percent) makes starkly apparent that these traders were able to successfully execute the arbitrage policy at Katy in the investigative period. *See* Figure 9.[132] Thus, their failure to execute the stated arbitrage policy at HSC fifty percent of the time was a choice, not the result of market forces.

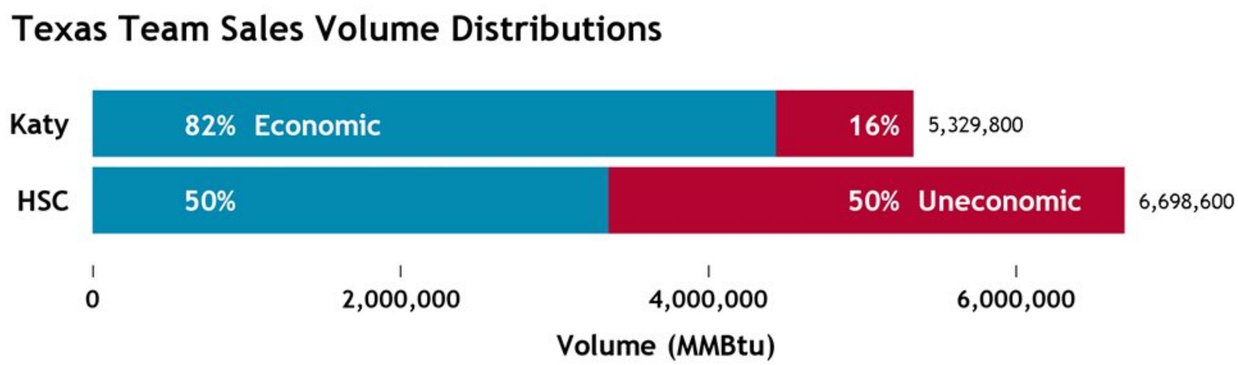

Figure 9

Analysis of all of the HSC sales in the context of the stated arbitrage strategy proves that Luskie was correct when he told Parker that the Texas team was making trade and transport decisions to affect the HSC index. In the investigative period, one-third of the Texas team's HSC sales volume was traded largely uneconomically prior to the Katy market opening and only half of the remaining two-thirds of volume that was sold while Katy was active was economically justified under the arbitrage strategy. Combining the analysis of the prior three sections, Figure 10 shows that only thirty-three percent of the Texas team's sales volume was economically arbitraged during the investigative period.

[132] About one percent of HSC sales and two percent of Katy sales did not have comparable prices and were excluded from the analysis. Thus, the percentages in this graph do not add up to one hundred percent. This graph only depicts HSC sales made after Katy's first trade each day.

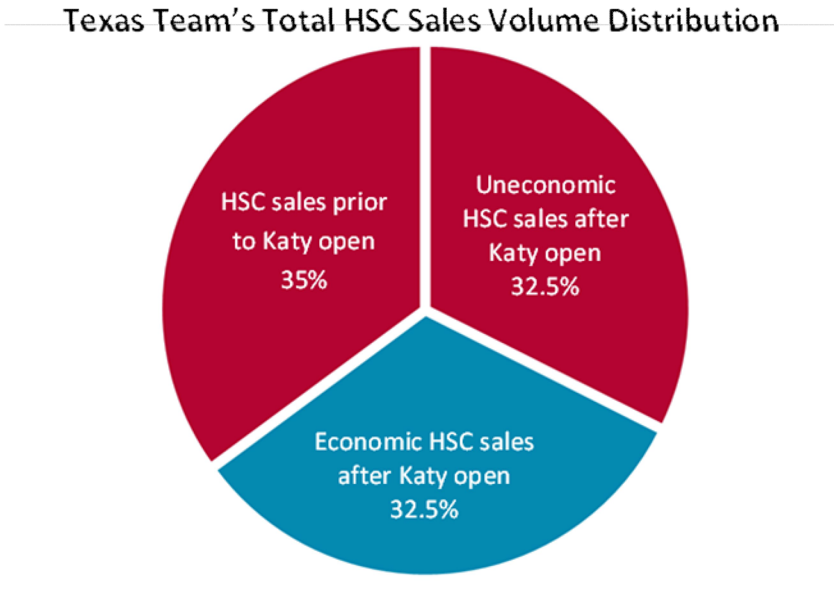

Figure 10

E. The Texas Team Experienced Greater Losses on their Physical Sales at HSC

BP tracked the Texas team's daily PnL for their physical trading at Katy and HSC on the Katy-Ship Excel Sheet (Katy-Ship Sheet).[133] This daily PnL calculation included the Texas team's performance against the HSC and Katy GDDs, factoring in the cost of transport from Katy to HSC. While the Katy-Ship Sheet combined all these factors into a single PnL number, staff isolated the PnL on the Texas team's fixed-price sales at HSC made on ICE and found that the Texas team suffered greater losses on its sales at HSC in the investigative period.[134]

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[133] BP Transmittal Letter in Response to Eighth Data Request No. 44 (Dec. 15, 2011).

[134] The Katy-Ship Excel Sheets calculated both "Transport PnL" and "Cash PnL." "Transport PnL" showed whether it had been economic to ship gas from Katy to HSC on that day. Transport PnL was positive when the HSC-Katy spread was greater than the cost of transport. "Cash PnL" showed whether the Texas team's trades at each hub "beat" that hub's GDD (as measured by the difference between the Texas team's transaction prices and the hub's GDD).

The Texas team sold physical gas at HSC for a slight profit from July 2008 through September 11, 2008. For example, in August 2008, the Texas team sold at HSC below the HSC GDD but made money by capturing the difference between Katy and HSC with its transport capacity – to post a profit on its HSC sales for the month of about $4,000. Before the hurricane period in September 2008, the Texas team posted a positive PnL of about $1,300 on its HSC sales on both transport and against the HSC GDD.

The small net gains for August and the first part of September were consistent with the Texas team's arbitrage strategy set forth in the HPL Transport Memo. Under a trading strategy based on penny differentials between two hubs, it is not likely one would see either great gains or steep losses at either hub. Rather, the Texas team's arbitraging of Katy and HSC was a low risk/low reward, "grind it out" trading strategy, that if well-executed, would yield a small but steady return.[135]

Beginning on September 18, 2008, however, the Texas team traders incurred above average losses on their sales at HSC and continued to incur those losses throughout the investigative period. In just two weeks of trading, from September 18, 2008 until the end of September 2008, the Texas team lost about $38,000 on its HSC sales, most of which was the result of transporting gas to HSC when daily index prices dictated that their Katy gas should have been sold at Katy. In October 2008, the Texas team's sales at HSC lost money on both transport and against the HSC GDD for a total of about $88,000.[136] The Texas team also posted a $22,000 loss in November 2008.

In contrast, from September 18 through the end of November 2008, the Texas team posted a profit of about $46,000 on their Katy sales.[137] Thus, once again, the trading data reflects that during the manipulation, while the Texas team traders were capable of profitably selling at Katy, they consistently sold gas for a loss at HSC.

V. The Texas Team's Financial Position and Luskie's Outline of the Manipulative Scheme

In the recorded call, Luskie stated his concern that the Texas team was using its physical trading and transport to "affect the index" and "help our paper position."[138] In

[135] Squeezing some profit from the otherwise unprofitable HPL transport was just one part of Comfort's duties. He also traded daily and monthly gas at other points.

[136] Not once during 2008 did the Texas team's fixed-price trading at HSC incur the magnitude of losses they suffered in October.

[137] BP calculated Katy PnL by comparing the Texas team VWAP against the Katy GDD because no transport costs were incurred selling Katy gas at Katy.

[138] Appendix B.

this Part, staff demonstrates that Luskie was correct: the motive for the manipulation was to help the Texas team's financial position. Analysis shows that in mid-September 2008, the Texas team observed potential windfall profits on their pre-existing HSC-Henry Hub swing spread after Hurricane Ike caused HSC gas prices to plummet. Using PnL estimates, the origin of the manipulation appears to have been the Texas team's desire to slow the return of HSC physical prices to their pre-hurricane relationship to Henry Hub, and thereby continue to reap outsized returns on the swing spread position. When the manipulative scheme appeared to work, the traders increased their financial position for October and later extended the manipulation into November. At the same time, the Texas team bought more Katy and HSC physical gas to suppress the HSC physical market.

To better understand the traders' calculus in proceeding with this scheme, this Part also examines the rewards and risks that would have been apparent to the traders. First, the traders understood that the potential profits on the swing spread position would be larger than any potential losses from manipulating the physical market. Second, the Texas team traders likely believed the risk of detection was slim due to the unique circumstances giving rise to this manipulative scheme. Third, staff examines the Texas team's intra-day physical trading at HSC on several days in the investigative period to provide granular proof that the Texas team disregarded higher-priced opportunities when selling fixed-price gas at HSC.

A. The Potential for Windfall Financial Profits

For purposes of this section, an understanding of only two features of the financial products' PnL is necessary. First, the end-of-month PnL on the Texas team's spread position depended on whether the spread between the *Gas Daily* indices at HSC and Henry Hub was wider over the month than the spread between the HSC and Henry Hub IFERC prices established in bid week before the month began. Because each hub's monthly *Gas Daily* index was an average of each day's fixed-price gas trading, suppressing each day's *Gas Daily* daily (GDD) would improve the likelihood that the Texas team's HSC-Henry Hub swing spread position would be profitable.

Second, to make daily trading decisions, BP calculated a mark-to-market valuation for every position using current market prices and information. Therefore, the Texas team traders knew, each day, BP's best estimate of the current value of their swing spread position.[139] With this background, this section examines the Texas team's daily mark-to-market PnL on the swing spread position at key moments and shows how these daily valuations influenced the Texas team's decisions to begin and to continue the manipulation.

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[139] Staff used BP's daily marks to estimate the daily mark-to-market PnL. While not exact, staff's PnL calculations fairly represent the forward-value of the Texas team's positions that the Texas team traders saw as they made their trading decisions.

1. September 2008: Hurricane Ike

Although the Texas team had a HSC-Henry Hub swing spread position on for September 2008, their expectations for this position going into the month were likely to have been modest. First, the September position was about thirteen contracts, which was not a particularly large financial position on the SEGT book. Second, in the four months prior to September 2008, the spread between the HSC and Henry Hub *Gas Daily* indices had ranged between just $0.15 and $0.27 and no market news suggested that a magnitude shift in the spread or greater volatility was imminent. Third, the PnL on the Texas team's similar sized HSC-Henry Hub swing spread positions for July and August 2008 had been negative – totaling a loss of approximately $113,000 for these two months. Nor was the September swing spread position shaping up any better. In the first week and a half of September, the HSC-Henry Hub *Gas Daily* spread again narrowed.[140] Thus, before Hurricane Ike, it would have looked to the Texas team traders that their September HSC-Henry Hub swing spread position might also be headed for a loss.

But everything changed after Hurricane Ike hit the Gulf Coast. Hurricane-related disruptions caused HSC gas prices to plummet – resulting in a spread between the Henry Hub and HSC GDD indices of $1.72 on September 13, 2008.[141] By September 18, 2008, the spread between HSC and Henry Hub GDD indices further widened to $2.345, for a projected monthly profit on the swing spread position of about $2,000,000.[142] Luskie remembers that, during this week, Barnhart was "quite excited about the P&L" on the HSC-Henry Hub spread position and that she went around "giving high fives."[143] During this same week, the Texas team also began its heavy, one-directional selling of physical gas at HSC and started buying more Katy physical gas for October.

For the rest of September, the Texas team's efforts to slow the narrowing of the HSC-Henry Hub GDD spread were successful, because although the spread shrank from its immediate highs after Hurricane Ike, the spread did not return to its pre-hurricane September average of $0.26 (even after the hurricane-related problems subsided in the

[140] The month had started with a profitable spread in the position but the market turned against the position over the next eleven days.

[141] There was a slight rise in the GDD spread in the few days leading up to Hurricane Ike, but as late as flow date September 12, 2008, the spread was only $0.465.

[142] BP's records reflect that on September 18, 2008, SEGT had the HSC September *Gas Daily* index marked at $6.681 and the Henry Hub *Gas Daily* index marked at $7.681, for a $1.00 spread.

[143] Luskie Dep. Vol. I at 308:8-17.

region). Rather, the spread stayed above $0.80 through September 24, 2008, before finally dipping to $0.425 on September 30, 2008. Thus, when the September *Gas Daily* spread between Henry Hub and HSC settled at $0.835, the Texas team realized approximately $2,400,000 in profit on the September swing spread position.

2. October 2008: The Manipulation Continued

During September, the Texas team demonstrated their intent to continue to suppress the HSC *Gas Daily* index in October by increasing their October Katy and HSC physical positions. The Texas team traders, however, appear to have been ambivalent about committing more resources on the financial side of the manipulation. In mid-September, they initially increased their October HSC short swing position but then reduced it later in the month.[144] Their caution was likely a reaction to market signals in late September that indicated that HSC physical prices might be returning to their pre-Hurricane Ike relationship to Henry Hub.[145]

On October 1, 2008, however, the HSC-Henry Hub GDD spread opened at $0.40 for an immediate $0.19 differential from the October HSC-Henry Hub IFERC spread. At this point, it was apparent to the Texas team traders that they could continue to generate profits from the manipulation by keeping the HSC-Henry Hub GDD spread each day near the opening October GDD differential of $0.40 and realize approximately $0.19 per contract profit on the swing spread. To capitalize on this opportunity, in October the Texas team increased their October swing spread through BOM purchases and sales of Henry Hub and HSC swing swaps.

The Texas team's increased financial position for October paid off. Contrary to the market's expectation of a narrowing spread, as expressed in the $0.21 HSC-Henry Hub October IFERC spread, the Texas team traders' heavy and early selling kept the HSC-Henry Hub GDD spread consistently in the $0.40 range throughout most of

[144] The Texas team began September 2008 short about fifteen October HSC index swaps but as the HSC-Henry Hub GDD spread widened, the Texas team increased its HSC short index swap position to twenty contracts. But, on September 25, 2008, as the HSC-Henry Hub GDD spread began to significantly shrink from its post-hurricane high, the Texas team reduced its short October HSC index swap position to fewer than nine contracts before ending September short about thirteen October HSC index swaps.

[145] In bid week for October, the HSC-Henry Hub IFERC spread settled at $0.21, a number consistent with this spread's typical performance in 2008 (and much lower than September's $0.835 HSC-Henry Hub *Gas Daily* spread), suggesting that market participants anticipated that the HSC-Henry Hub relationship would return to its pre-Hurricane Ike levels.

October. Thus, when the October *Gas Daily* index spread settled at $0.405, the Texas team reaped about $880,000 in profits, of which about $130,000 was due to the increase in its initial thirteen contract spread to the larger twenty-one contract spread.

3. November 2008: The Market Turns

The Texas team traders' decision at the end October to create a November HSC short position in index, swing swaps, and basis swaps reflected their decision to try to extend their unlawful profits for yet another month. However, the HSC market turned against the Texas team's manipulative scheme that month. As a result, while the Texas team continued its efforts to suppress the HSC *Gas Daily* index, their HSC physical sales in November were used to mitigate their financial losses rather than reap greater profits.

Estimating the PnL on the Texas team's November financial position requires more analysis because of the interplay between the Texas team's November swing spread position and a related November HSC short basis swap position. By acquiring a similar-sized November short HSC basis swap position and a HSC-Henry Hub swing spread position, the Texas team created a type of "combo" position.[146] The PnL on this "combo" position depended on whether the HSC-Henry Hub *Gas Daily* indices spread was wider than the average purchase price of the Texas team's November HSC short basis swap position, which was about $0.53.

Initially, their decision to create a "combo" position proved advantageous for two reasons. First, the November HSC basis narrowed which favored the Texas team's short basis swap position. Staff estimates that this position generated approximately $2,000,000 in profits,[147] which was marked on BP's book to the Texas team at the end of October.[148] Second, when the HSC-Henry Hub IFERC spread set in bid week at $0.75, the Texas team traders found themselves in a better position going into the month. The

[146] *See* Affidavit of Souad Mahmassani in Response to June 6, 2012 Tenth Data Request, Question No. 46 (July 6, 2012).

[147] This $2,000,000 was the profit for the Texas team's entire November short basis swap position. For calculating the PnL of the manipulation, staff used only the number of basis swaps that numerically matched off against the smaller swing spread position.

[148] Basis swap PnL is final at the end of bid week of the month prior to flow, not over the course of the flow month (as with index and swing swaps). BP did not retain the prices it paid for the HSC November basis swaps, thus staff used BP's daily marks for HSC basis swaps as the execution price. Any difference between the marks and the Texas team's actual trade price would have been just a penny or two premium or discount, which would not significantly change staff's calculation of the financial PnL.

"combo" position only required that the spread between the HSC and Henry Hub *Gas Daily* indices settle wider than the $0.53 it paid for the basis swaps, rather than $0.75 IFERC spread, for the manipulation to be profitable in November.[149]

The HSC physical market in November, however, did not behave as the Texas team anticipated. Despite heavy selling by the Texas team on the first trade date for November (October 31), the HSC-Henry Hub GDD spread opened for the month at $0.455.[150] This required the Texas team to take an immediate mark-to-market loss on their swing spread position.[151] Despite the Texas team's continued selling of more of its Katy gas at HSC throughout the month, the spread between the HSC and Henry Hub *Gas Daily* indices settled at $0.465. This spread was narrower than the $0.53 average sale price for the basis swaps. Staff estimates that the Texas team's November "combo" position of a HSC-Henry Hub swing spread and HSC short basis swaps lost approximately $400,000.[152] Despite the November loss, the Texas team still made approximately $1,785,000 on its HSC financial short position over the course of the investigative period.[153]

B. The Limited Risk of Physical Losses

Traders constantly weigh risk and reward. In mid-September 2008, when the HSC-Henry Hub GDD spread increased to over $2.00, the Texas team's financial incentives on the swing spread were in the millions of dollars if they could successfully slow the return of the HSC-Henry Hub GDD spread to its pre-Hurricane Ike range. As important, the traders knew that the likely physical side losses would be small because most of the Katy gas they would sell into the HSC fixed-price market was marked at the

[149] In the end, this basis position spared the Texas team $0.22 of additional losses per MMBtu they would have incurred had they held only the HSC-Henry Hub swing spread.

[150] The Texas team's selling on this day is discussed *infra* at Part V(E)(2).

[151] Although the Texas team conceived of the basis swap and swing swap positions to have been a linked position, these positions were still separate on BP's book and the PnL on these positions was realized at different times.

[152] Again, this occurred because in November the Texas team's swing spread was smaller than its HSC short basis swap position. To make the "combo" PnL calculation, staff used an amount of basis swaps equal to the smaller swing spread position.

[153] This amount excludes profit on the swing spread for flows from September 1-18, 2008, before the manipulation began.

HSC GDD on BP's books.[154] Thus, the daily physical gas they would use to manipulate the HSC index was valued at the very index they were trying to suppress. As a result, the only daily physical trading losses the Texas team risked at HSC would be when (a) the Texas team's daily sales VWAP at HSC were under the HSC GDD or (b) the Katy GDD was higher than the Texas team's HSC sales VWAP including transportation costs.

In addition, minimizing their HSC physical losses from uneconomic trading on most days would not be difficult. First, the Texas team's fixed-price PnL was generally so small that the Texas team did not track it closely and considered it "immaterial" relative to their other positions.[155] During the investigative period, the Texas team had enough Katy gas to constitute on average approximately thirty percent of the daily HSC physical market. Thus, if the traders transported most of their Katy gas to HSC each day, their HSC VWAP was unlikely to be very far from HSC GDD. In addition, to the extent that the Texas team passed up higher priced opportunities at Katy to sell gas at HSC, these losses would show up in the Katy-Ship Excel Sheet under "transport PnL." But because Katy and HSC generally traded so closely, the traders could be confident that the risk of large transport losses was likely to be small. The Texas team traders also knew they could stop their physical losses at any time simply by either selling more economically at HSC, selling more Katy gas at Katy, or by disposing of some of their Katy gas in a balance of month trade. Finally, the Texas team was only trying to slow the shrinkage of the GDD spread in September rather than widen the spread (and in October, just hold the spread steady). Therefore, they did not have to sell aggressively at HSC to accomplish the goal of the manipulation. For these reasons, the Texas team traders knew from the start that they would only have to risk small losses on the physical side to reap larger profits on their financial position.[156]

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[154] Luskie Dep. Vol. I at 160:18-161:22; 165:21-23. BP's records are not clear how much of the Texas team's Katy long physical position was bought at GDD versus bought at fixed-price or Katy or HSC IFERC index price. Staff was able to determine that a sufficient percentage of the gas was valued at the HSC GDD such that the physical PnL was based in whole or in part on the HSC GDD.

[155] *Id*. at 160:18-161:22.

[156] BP's contention that "leverage is needed to ensure that a relatively small loss in physical sales can be offset by a significant profit in the opposite financial position, resulting in a meaningful overall profit," fails to take into account that BP marked much of its Katy gas to the HSC GDD. BP's Response to Preliminary Findings Letter at 19. An example shows how a penny lost in physical trading could result in more than a penny gained by the financial position. Assume that a trader makes six offers to sell fixed-price physical gas at $4.00 per MMBtu and that each offer is lifted. Assume that other sales that day are for $4.75, $5.00, $5.00 and $5.25. The volume weighted average price is $4.40 (the sum of all sales divided by the number of sales, or $44.00 divided by ten). The

C. Hurricane Ike's Wake Made the Risk of Detection Low

For traders contemplating an illegal scheme, the risk/reward calculus must also include the likelihood of detection. Here, staff concludes there were many reasons for the Texas team traders to believe their efforts to suppress the HSC physical market would go unnoticed.

First, this scheme was less likely to be detected because in mid- to late September, the Texas team's goal was not to move a physical price in the direction that would benefit their financial position. Hurricane Ike had already done that work for them and made the post-hurricane HSC-Henry Hub GDD spread wider than the Texas team traders could have imagined when they put on the September swing spread position. The Texas team could reap windfall profits simply by slowing down the return of the HSC-Henry Hub spread to pre-hurricane levels.[157] Thus, a compliance review would have shown that their financial spread position was becoming *less profitable* despite the Texas team's increased physical sales at HSC. Similarly, in October, the Texas team only needed to hold the HSC-Henry Hub spread steady to generate a substantial profit on their swing spread position.

Second, turmoil in the wake of Hurricane Ike provided additional cover for the Texas team traders at the start of the manipulation. The Texas team and many other BP personnel were in Austin in temporary facilities when the Texas team began increasing

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trader will have lost \$0.40 on each sale (the fixed physical price (\$4.00) - the index price (\$4.40), which the trader helped establish) for a total loss of \$2.40 against the index. But, in the absence of the trader's uneconomic sales, the index price would have been \$5.00 (4.75 + 5.00 + 5.00 + 5.25 divided by the number of sales or four). Thus, the trader would have moved the index by \$0.60 (the difference between 5.00 and 4.40), even though the trader only lost \$0.40 on each physical sale. If the trader possessed six swaps that benefited from the index price dropping, he would have made \$0.20 more on each swap (the difference between \$0.60 index move and the \$0.40 physical losses). This demonstrates that even without leverage, the Texas team could have made greater profits on the swing spread than it lost on arbitrage opportunities in the physical market, depending on the extent to which the Texas team was able to move the index. In any event, the traders clearly believed that their spread position had a greater potential for gain or loss than any potential fixed-price losses. Luskie Dep. Vol. I at 160:18-161:22; Luskie Dep. Vol. II at 350:1-351:24.

[157] Because each trading day in September made up 1/30 of the September *Gas Daily* index, every day the traders could keep the spread from shrinking, if only by a few cents, translated into greater profits.

their HSC sales. At that time, BP personnel, including the Texas team's supervisor Kevin Bass, were in crisis control mode.[158] With pipelines shut down and hurricane damage in the region, BP's immediate focus was in ensuring they could meet their delivery and receipt obligations to customers and suppliers, not looking for trading irregularities. Prices also fluctuated considerably during and after the hurricane, providing a ready excuse for changes in the Texas team's physical trading. Moreover, during the week of September 15-19, 2008, when the manipulation began, both the compliance department analyst, Steve Simmons, responsible for overseeing the Texas team and his supervisor, Mark Galicia, had already returned to Houston while the traders remained in Austin.[159]

Third, although the manipulation might generate losses on the physical side, the way that BP calculated the Texas team's physical PnL would work to disguise their losses in the HSC market. Specifically, the Katy-Ship Sheet combined the Texas team's physical trading at Katy and HSC into one bottom line number. As shown in Part IV, because the Texas team continued to trade economically at Katy, losses they suffered at HSC against the index or on transport were less likely to be noticed because they were combined with the stronger Katy results.

D. Comfort Needed a Profitable Trading Year

A trader's personal motives are also relevant in assessing why he chose to violate the law. Comfort did almost all the HSC fixed-price trading in the investigative period and he added most of the BOM October swing swaps and put on the majority of the November HSC index swap position. He also had the strongest personal need for a profitable year for his team.

His negative 2007 review had forced him to seek another trading position at BP and once he landed a position on the SEGT Texas team, his transition to this new trading desk was not without significant bumps. In June 2008, after just six months on the Texas team, where he traded both physical and financial products, BP shifted him to the less lucrative role of primarily physical trading. However, because Comfort made some of the key financial trades that expanded the swing spread in October and for November, and because the Texas team's overall results were used in computing bonuses, Comfort

[158] In addition, many BP personnel had personal concerns related to storm damage. There was also considerable market turmoil due to the financial crisis in New York.

[159] Steve Simmons also left his BP computer in Austin and thus had no means to continue his duty to review the Texas team's daily trading activity. Nor is there any record that reflects that he reviewed their trading for this week when he returned to the office on September 22, 2008.

had every reason to believe that a very profitable year in financial trading for the Texas team would redound to his benefit come bonus time and in his evaluation.[160] Comfort also understood the interaction of the financial and physical markets, having been a financial trader for many years. Thus, Comfort had the necessary motivation and expertise to involve himself and his team in an illegal "physical for financial" market manipulation, particularly one that promised substantial returns with little risk of loss or detection.

E. Intra-Day Physical Trading Intended to Benefit the Financial PnL

Close examination of several trading days in detail illustrates how the Texas team executed physical gas trades without regard for the stated arbitrage strategy.[161]

1. October 17, 2008: Luskie Executes Comfort's Trading Strategy at HSC

On October 17, 2008, Comfort was out of the office and Luskie handled all of the physical trading at Katy and HSC.[162] Luskie exclusively sold at HSC, while both buying and selling gas at Katy. Luskie's HSC sales in the fixed-price ICE market were also heavy, totaling 120,000 MMBtus per day.[163] Out of these 120,000 MMBtus, Luskie sold 100,000 MMBtus per day at HSC before Katy opened and all of his pre-Katy sales were at prices below the Katy opening price. *See* Figure 11. This early sell-out resulted in a loss against the HSC index of $5,400.00.[164]

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[160] Comfort Dep. Vol. II at 248:7-251:17.

[161] The aggregate data in Part IV shows that the Texas team altered its previous trading patterns and traded uneconomically at HSC. Staff does not contend that the traders executed every element of the manipulation in the same way on each day.

[162] Luskie also traded for Comfort on October 16 and 24, 2008.

[163] Because this was a mid-month Friday, each trade represented three days of flow, or 360,000 MMBtus, and therefore, prices on October 17, 2008 constituted one-tenth of the September HSC *Gas Daily* index.

[164] Luskie was on the sell side of the first two HSC trades. After Katy opened, Luskie made only two more HSC sales. Within forty-five minutes of the first HSC trade, he was finished trading at HSC for the day.

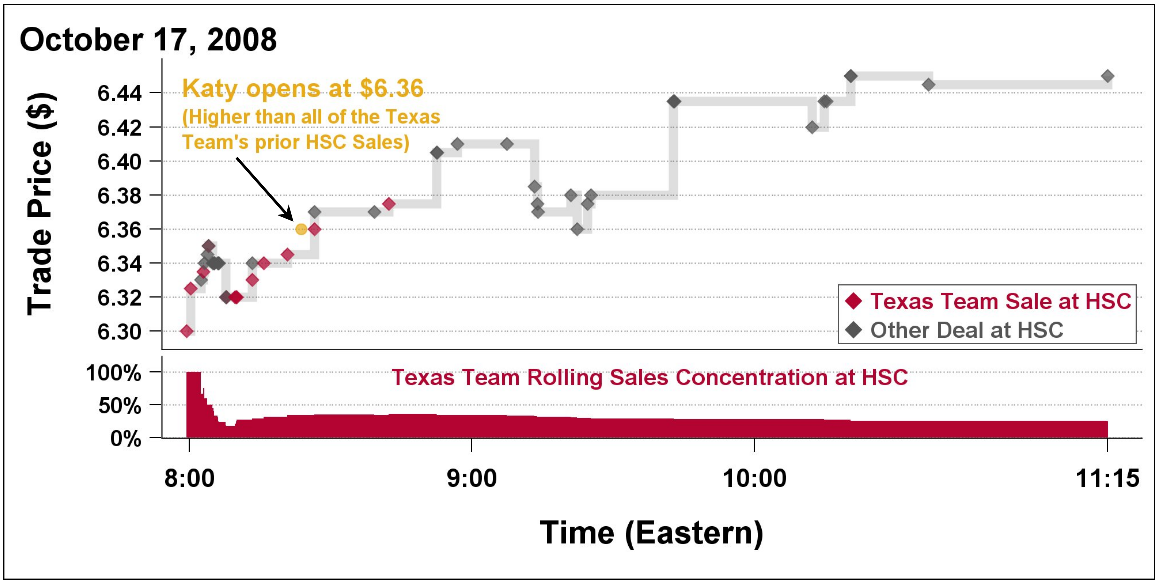

Figure 11

Based on this trading pattern, staff concludes that on October 17, 2008, Luskie followed Comfort's October trading pattern of selling early at HSC without regard to Katy prices or the possibility of physical trading losses. Luskie did so because either he was instructed to by Comfort or he mimicked what he had seen Comfort doing over the past few weeks.[165]

This conclusion is supported by the fact that Luskie traded virtually the same way the day before and had lost money. In fact, in a memo Luskie wrote to update the rest of SEGT on the Texas region's October 16, 2008 activity, Luskie predicted that, going forward, Katy was likely to continue to trade over HSC.[166] Luskie acknowledged that

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[165] On October 17, 2008, Luskie was still a very junior trader on his first trading assignment at BP, and most days his trading responsibilities were limited to balancing transport capacity on one intrastate pipeline. Still, Luskie denies that Comfort instructed him how to trade in his absence. Luskie Dep. Vol. I at 236:14-20. However, Luskie agreed that he likely shared the same macro-view of the HSC market as Comfort in this period, and that he would have been more cautious in his trading if he had chosen to depart from that view on a day he traded for Comfort. Luskie Dep. Vol. I at 202:11-16.

[166] Luskie Dep. Vol. I at 107:23-108:6; BP-L 00205029 (stating that "On an intrastate basis, Katy traded over Ship tick for tick all morning long. It appears that this will be the case as long as mid-continental is short molecules."). In retrospect, Luskie recognized that he sold too early on both October 16 and October 17, 2008 and he had no good explanation at his deposition for why he did so. Luskie Dep. Vol. I at 227:7-228:6; 245:2-10. Neither Comfort nor Luskie remember any criticism or correction to Luskie

this prediction counseled that he should have "wait[ed] and [sold] my gas at Katy." He could not therefore explain why he traded early and heavily at HSC on October 17, 2008 except to say that there must have been other factors involved.[167]

2. October 31, 2008: The November Mitigation Efforts

Comfort's trading on October 31, 2008 reflects a stark example of the Texas team's altered trading pattern at HSC in the investigative period. Comfort's aggressive trading at HSC was likely prompted by two factors. October 31, 2008 was a Friday and accounted for three flow days, meaning the day's GDD comprised one-tenth of the HSC November *Gas Daily* index. Also, gas traded on this day flowed on November 1, 2008 (the first GDD for November), and thus would be the market's first signal about the November relationship between the HSC and Henry Hub fixed-price markets.[168]

During the first twenty-four minutes of trading, Comfort made twelve fixed-price HSC sales on ICE, totaling 130,000 MMBtus per day. These twelve early sales constituted sixty percent of the HSC early market. After this initial burst of trading, the Texas team stopped trading at HSC for the day without buying a single fixed-price

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when Comfort returned to the desk. Comfort claimed to have no memory of Luskie trading in his absence, and therefore, no memory of reviewing his trades. Comfort Dep. Vol. III at 495-496; 498-500; Luskie Dep. Vol. I at 215:7-11.

[167] Staff's conclusion that Luskie did not faithfully execute the arbitrage strategy on October 17, 2008 is also supported by trading data from August 21, 2008, when Luskie traded for Comfort. On that day, Luskie did most of his fixed-price trading when both Katy and HSC were open and he bought and sold at both locations throughout the session, ultimately making money on the day. Luskie agreed that he appears to have successfully executed the arbitrage strategy on this trade date. Luskie Dep. Vol. I at 196:18–197:13. Luskie also agreed that his trading at Katy on August 21, 2008 and on October 16 and 17, 2008 appeared similar but that his HSC trading in October featured more early selling than his trading at HSC in August. Luskie Dep. Vol. I at 263:1-264:4.

[168] Before trading began on October 31, the Texas team traders knew that the November spread between the HSC-Henry Hub *Gas Daily* indexes had to be wider than $0.53 for their combined basis swap and swing spread position to be profitable. The traders also knew that in bid week, the November HSC-Henry Hub IFERC spread had set at about $0.75 – considerably higher than the September and October HSC-Henry Hub IFERC spreads, and hence, a potential worrisome portent for the start to the November HSC – Henry Hub GDD spread.

MMBtu there.[169] These twelve HSC sales illustrate the Texas team's use of heavy, early selling to "frame the market" and thereby suppress the developing HSC VWAP.[170]

Even as Comfort sold early at HSC on October 31, 2008, he also bought fixed-price gas at Katy early in the trading session.[171] These early Katy purchases belie BP's "baseload" argument that the Texas team traders had to sell early and heavily at HSC to ensure they could sell out their October and November Katy long positions. If the Texas team traders were worried about being able to sell out their Katy position, Comfort would not have added more volume to that position during the fixed-price trading session. *See* Figure 12.

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[169] Other parties consummated twenty-four more trades that day after Comfort stopped selling.

[170] The spread established by the first HSC and Henry Hub trades may also have influenced Comfort to react as he did. On October 31, 2008, HSC and Henry Hub began trading within twenty seconds of each other. The Texas team was not part of the first HSC trade, and the spread set by the first trades at HSC and Henry Hub was $0.45 – below the Texas team's target of at least $0.53 for its financial position. Within two minutes of these first HSC and Henry Hub trades, the Texas team entered the market and hit a bid at HSC for 30,000 MMBtus per day – a price that was $0.05 below the first HSC trade. Three minutes later, the Texas team hit another 30,000 MMBtu per day bid at $0.04 below the HSC first trade. These two Texas team sales represented eighty percent of HSC volume in the first five minutes of trading. Staff concludes that Comfort, upon seeing the unfavorable opening HSC-Henry Hub spread, tried to move the HSC VWAP lower to reverse or at least contain the damage. Even so, the HSC-Henry Hub GDD spread set at $0.45 on October 31, 2008. Reflecting this reality, Luskie testified that the Texas team knew their swing spread position was a money loser from day one in November. Luskie CFTC Dep. at 126:22.

[171] For example, the Texas team bought at Katy at 8:17 a.m., 8:27 a.m., 8:29 a.m., and 8:32 a.m. for the following quantities of gas – 25,000, 10,000, 10,000, and 10,000 MMBtus (per day for three days) respectively.

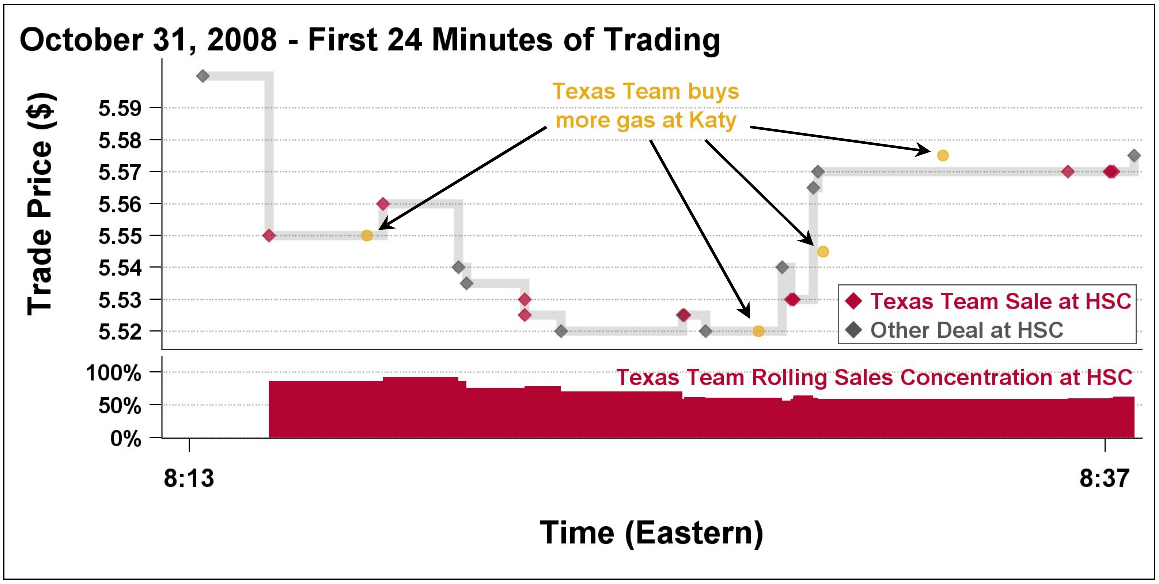

Figure 12

A trade-by-trade analysis of the Texas team's October 31, 2008 HSC sales also reveals instances of uneconomic trading versus Katy prices (trades for which the Texas team's sales at HSC did not cover the $0.013 transport differential). For example, the Texas team's last three trades were sales resulting from lifted offers of $5.57 when Katy's lowest offer was $5.58.[172]

On this day, the Texas team lost more than $75,000 against the HSC index. Later in the trading session, HSC prices rose against Katy, with the HSC GDD ultimately settling $0.095 higher than Katy. Had Comfort waited to sell at HSC, or sold ratably at HSC throughout the day, the Texas team would have likely shown a daily profit instead of this large loss.

Thus, on October 31, 2008, rather than faithfully execute the arbitrage strategy, the Texas team pulled out all the stops to suppress the HSC GDD in an effort to influence one-tenth of the November HSC *Gas Daily* index and the market's first impression of the HSC fixed-price market for the month.

3. <u>November 3, 2008: "Ship was Brutal"</u>

November 3, 2008 was the day that Luskie called in from the ATC and spoke with Barnhart and Comfort about how HSC had traded that day. As discussed in Part II, in the

[172] These trades should be considered uneconomic because the Texas team could have shown offers at Katy at the same price of their consummated HSC sales ($5.57). If these offers were lifted at Katy rather than at HSC, the Texas team would not have had to pay transport costs.

November 3rd call, the Texas team traders indicated their desire for HSC physical gas prices to weaken over the month because of their short position at this hub and bemoaned how strong the HSC market was that day compared to other points. This phone call and Comfort's trading on November 3, 2008 together illustrates (a) that the Texas team's primary concern was their financial position, and (b) their utter lack of interest in their PnL on their physical sales in the HSC fixed-price market.

On November 3, 2008, Comfort again sold heavily at HSC before Katy opened and bought gas at Katy early in the trading session.[173] Comfort also "packed the pipe" that day – using 100 percent of the HPL capacity to transport gas from Katy to HSC. He even had to buy back gas near the end of the HSC session to avoid exceeding their maximum HPL transport capacity of 200,000 MMBtus.[174] Because HSC and Katy prices ran close throughout this day, there was no economic reason for the Texas team transporting so much of their Katy gas to HSC.

Moreover, Comfort's indifference to better price opportunities at Katy was apparent in his trading on this day. Shortly after 9:00 a.m., Comfort had four of his offers lifted at HSC over a short period for inferior prices relative to Katy when the cost of transport is included. Just a few minutes later, Comfort further demonstrated his disregard of the arbitrage strategy when he bought gas at Katy and then almost immediately made four sales at HSC at prices within $0.013 of the Katy purchase.[175]

Later in the session, HSC began trading higher. In this period, even though Comfort sold no gas at HSC, he made another purchase at Katy. Just a few minutes later, Comfort made eight rapid fire sales at HSC as the HSC price dropped, ultimately selling at the low of the day.[176] This record establishes that in this timeframe (in light green on

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[173] The Texas team made sales of $6.15, $6.16, and $6.15 at HSC before Katy opened. The Katy buys were at 8:54 a.m. at $6.235 and 9:08 a.m. at $6.15.

[174] The Texas team sold 206,000 MMBtus and made one purchase of 10,000 MMBtus with this purchase being one of the last three trades at HSC for the day.

[175] The first series of uneconomic HSC sales begin at 9:04 a.m. for $6.14. Contemporaneously, Katy's best offer was $6.15, and transacted at $6.14 around the same time. The second series of sales occurs between 9:08 a.m. and 9:14 a.m., when Comfort bought gas at Katy for $6.15 and $6.145. In the same period, he made sales at HSC ranging from $6.145 to $6.1575.

[176] From 9:21 a.m. to 9:33 a.m., there were five trades at HSC at prices ranging from $6.17 to $6.185 when the Texas team sold no gas at HSC. However, the Texas team purchased gas at Katy at 9:23 a.m. and 9:25 a.m. for $6.185. At 9:35 a.m., the

the chart below) Comfort was: (a) actively engaged in physical trading; (b) saw the higher HSC prices; and (c) yet chose not to sell at HSC but to buy at Katy, and (d) then continued selling at HSC. *See* Figure 13.

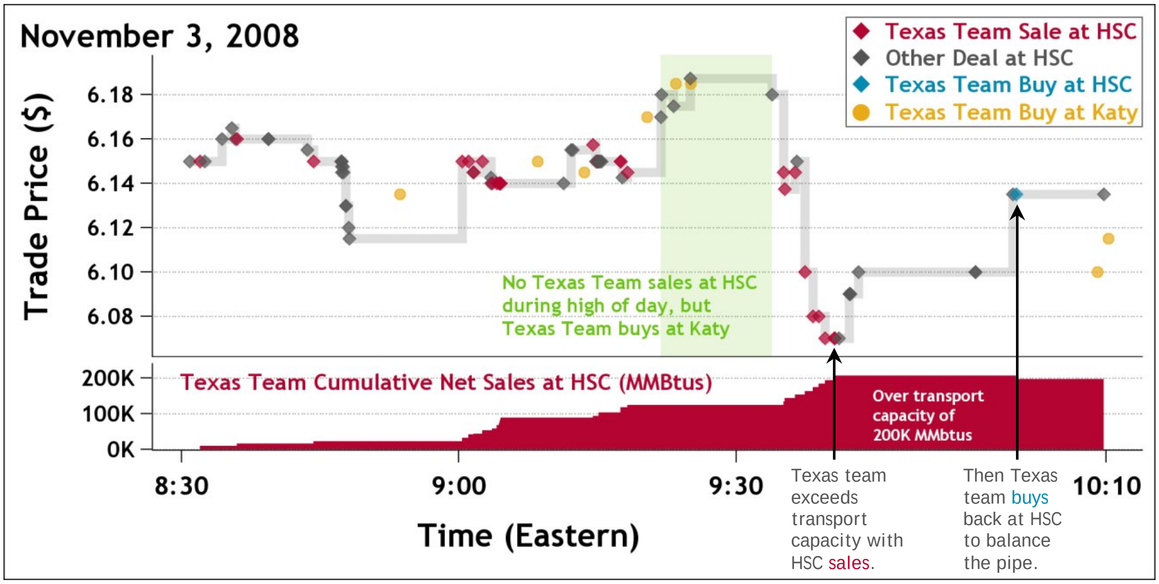

Figure 13

At the end of the day, the Texas team lost about $2,000 against the HSC GDD and more than $2,500 on transport. Yet, in the November 3, 2008 recorded call between Luskie at the ATC and Barnhart and Comfort on the desk after trading ended, there was no discussion about losing money on HSC fixed-price trading that day. Rather, Luskie's interest when he asks, "How was Ship?" was clearly about the HSC GDD and its impact on their spread position. Barnhart and Comfort share this focus because Barnhart responds "strong," Comfort immediately adds his comment, "brutal," showing that a strong HSC physical market is a problem for them. Barnhart makes this explicit at the end of the call when she says, "everything else is a piece of crap except where we are short." This call, in conjunction with their physical trading behavior at HSC that day, reflects that the Texas team traders were indifferent to fixed-price trading losses at HSC, because they were focused on their financial short position at HSC.[177]

Texas team resumed selling and made eight rapid fire sales at HSC of 10,000 MMBtu as the HSC price dropped from $6.145 to $6.07.

[177] On November 3, 2008, the HSC-Henry Hub GDD spread shrank $0.15 from the previous day to close at $0.305.

4. November 5, 2008: The Luskie Recorded Call Trade Date

Part II discussed Comfort's response to Luskie's request for an explanation of their HSC trading strategy on the November 5, 2008 recorded call. Comfort's trading on this day helps to explain his interruptions and fumbling on the recorded call.

Comfort sold the majority of his volume by hitting bids at HSC without placing any offers to sell at Katy, despite Katy opening just seconds after the first transaction at HSC. In other words, although both markets were open and Comfort had the "optionality" he claimed to prize, he was actually so indifferent to the stated arbitrage strategy that day that he did not even attempt to find buyers willing to lift offers at Katy before he settled for successively hitting bids at lower prices at HSC.[178] *See* Figure 14.

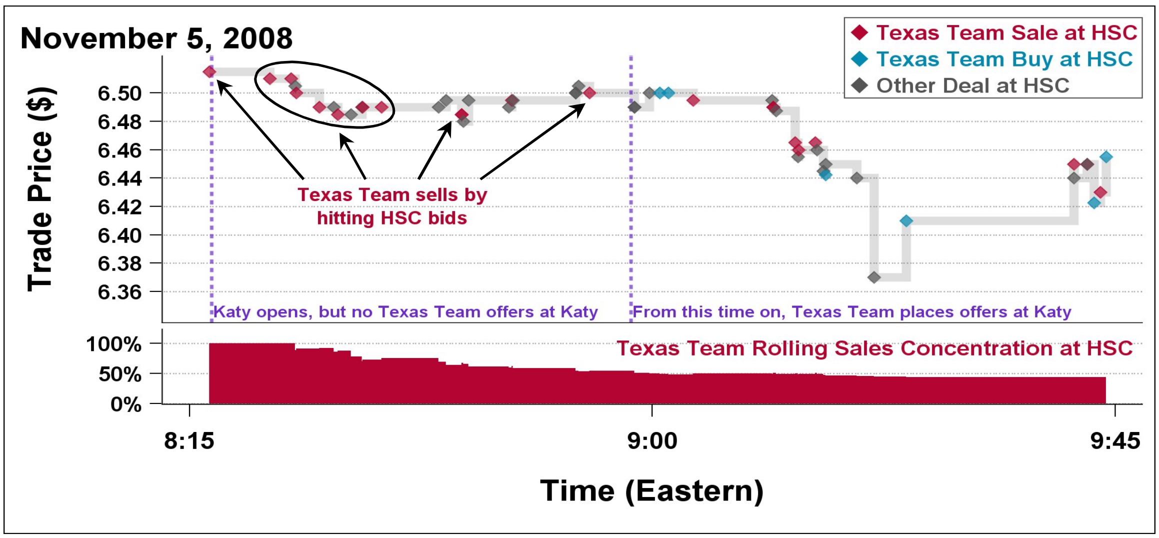

Figure 14

Comfort's sales on this day were also otherwise consistent with the Texas team's investigative period pattern of heavy, early selling. Comfort made his first HSC sale of the day for 20,000 MMBtus (this was also his largest volume trade of the day). Within

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[178] Comfort had offers posted at HSC while selling at HSC in this time. But, by choosing to hit increasingly lower bids in close succession, Comfort satisfied the existing demand as well as signaling to buyers that significant volume at buyers' bid prices was available. Thus, no early buyer would need to lift an offer from Comfort or another seller – guaranteeing that prices would not climb and would probably move downward. Luskie testified that seeing the bid stack hit progressively lower could indicate a shift in market momentum and that he pays attention to whether trades are made by hitting bids or lifting offers or a mix. Luskie Dep. Vol. I at 137:2-18.

the next seventeen minutes, Comfort was on the sell side of seven of the next eleven HSC trades.

There is no plausible economic explanation for Comfort's behavior in the first ten minutes of trading on November 5, 2008.[179] Comfort had the option of selling at Katy without transport costs. Comfort also knew there were buyers at Katy who did not have transport capacity and had positions that required them to be flat by the end of the day. Thus, when Luskie asked about whether their trading strategy amounted to market manipulation, Comfort likely knew that his own early trading behavior at HSC that day (and others) might look suspect.

The Texas team's uneconomic trading decisions on these sample days, combined with the aggregate economic analysis, the significant changes in the Texas team's trading patterns, and Comfort's behavior during and after the recorded call demonstrates that Luskie's roadmap of the manipulative scheme was accurate -- that the Texas team traded to suppress the HSC *Gas Daily* index to benefit their financial position.

VI. BP Compliance Failed to Take Luskie's Concerns about the Texas Team's Trading at HSC Seriously

The same day as the recorded call, Luskie spoke with a member of BP's Independent Monitor's ("the Monitor") team who was attending the ATC.[180] Thus, from the outset, BP knew there would be regulatory oversight of its response to the recorded call. BP directed its Compliance department to conduct an internal inquiry, and in just over a month, Compliance drafted a report ("the Compliance report" or "the report") which exonerated the Texas team of any wrongdoing.[181] However, the evidence reflects

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[179] HSC prices moved lower later in the trading session, which meant that the Texas team beat the HSC index and showed a slight profit on transport for the day.

[180] The Monitor employee, Dave Stephan, advised Luskie to contact BP Compliance. HSC Interview Summaries, Luskie Interview, December 16, 2008 (BP-L 00000123). Luskie and Comfort decided to report the matter to their supervisor, Bass, and to BP Compliance in their third cell phone conversation, after Luskie had already talked to Dave Stephan. *Id.* On November 6, 2008, Bass and Stephan listened to the call together and Bass then directed Simmons in an email to conduct an inquiry the same day. BPL F2 00090508. On November 6, 2008, BP provided the Monitor with a recording of the recorded call. On November 17, 2008, the Monitor provided the CFTC with a recording of the conversation. The CFTC provided a copy of the recording to OE that same day.

[181] Galicia took over drafting the report on November 21, 2008. A revised version of the report was provided to Tim Carey, BP Compliance, on February 4, 2009. After

that neither the Texas team's management nor Compliance took Luskie's concerns in the recorded call seriously. As a result, Compliance failed to gather critical trading data and the report failed to meaningfully analyze the trading data Compliance did collect.

In the very email that directed Compliance to conduct an internal inquiry, Bass told the Compliance analyst, Steve Simmons that he believed that there had been no improper trading. Comfort wrote a similar email to Simmons.[182] Within two weeks of the recorded call, internal emails reflect that Compliance shared this view. In a November 18, 2008 email to Mike Berry, the senior BP trading compliance officer for North America, Simmons wrote that he would be "taking Luskie outside after lunch to run sprints and do push-ups until he pukes." Simmons conceded that he would not have joked like this if he had viewed Luskie as having revealed a market manipulation.[183] In a similar vein, Berry responded that when he met with Luskie later that week, he "had something more fulfilling in mind."[184] These emails reflect that less than two weeks after the recorded call, both Simmons and Berry felt that Luskie was deserving of punishment, not praise, for bringing unwarranted scrutiny to the Texas team's trading at HSC, even though Compliance had not completed its analysis of the trading data nor even interviewed Luskie or the other Texas team traders.

Contemporaneous decisions by Compliance personnel to limit the inquiry ensured that BP would find no evidence of market manipulation. Just two days after the recorded call, Simmons wrote an email stating that the "scope of the inquiry is limited to Houston Ship Channel and our transport on HPL."[185] Simmons agreed at his deposition that that

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meeting with Carey, Galicia modified the report and resubmitted it to Carey on April 1, 2009. Galicia represents that the Compliance report was not distributed in any form to "trading personnel or supervisors." Affidavit of Mark A. Galicia in Response to March 25, 2009 Second Data Request, Question No. 10. Nor was the report submitted to the Monitor, the CFTC or to Enforcement. Staff obtained the report through a data request.

[182] Bass wrote, "I feel confident that we are trading appropriately around the transport . . . ." BPL F2 00090508. Comfort email to Simmons that, "In the optimization of this transport, I am confident we act properly and well within the parameters of both regulatory rules and BP compliance." BP-L 00015381.

[183] Simmons Dep. at 170:21-24.

[184] BPL F2 00092150. Email attached as Appendix D.

[185] BPL F2 00089332. Simmons said this email reflected his own opinion but that any final decision on the scope of the inquiry would have been made above him. Simmons Dep. at 162:7-8.

this email conveyed his belief that Compliance need not examine the Texas team's financial positions, even though Luskie had referred to "a paper position" in the recorded call.[186] Similarly, Simmons testified that this email precluded a review of the Texas team's Katy positions and Katy trading, despite the fact that Luskie's reference to the HPL transport meant that the Texas team was bringing physical gas to HSC from another point on the pipeline.

Limiting the scope of the inquiry permitted Compliance to complete its work extraordinarily quickly. Less than a week after the recorded call, Helen Quigley (who along with Simmons was initially responsible for conducting the inquiry), reported that she had "done enuf data mining" and needed to talk to the traders.[187] Interviews of Comfort and Luskie were conducted by BP Legal and Compliance and took place on December 4, 2008. However, Comfort and Luskie were not presented with, nor asked to explain, the data that Quigley had reviewed.[188]

Simmons and Quigley (with their supervisor Mark Galicia) submitted a completed draft of the Compliance report to Mike Berry on January 7, 2009.[189] The report states

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[186] Simmons could not remember why he wrote this email limiting the scope of the inquiry. Simmons Dep. at 160:19-161:5.

[187] *See* BPL F2 00090487. On November 18, 2008, Compliance updated its work plan but it is not clear whether any additional trading data was collected. Between November 20, 2008 and December 3, 2008, Compliance reviewed instant messages, emails, and voice recordings.

[188] The CFTC required BP to submit an outline of the questions it intended to ask the traders in these interviews. Although the CFTC provided edits to BP's outlined questions (and Enforcement staff made additional suggestions), neither agency limited BP from asking the Texas team traders about specific trading activity. Nor were there any questions in BP's initial outline of interview questions that referred to the data that Quigley had already pulled from BP's records. Thus, Comfort's and Luskie's interviews only covered the general scope of their duties and trading activities and the traders were allowed to deny any questionable conduct without being specifically asked to account for the changes in the Texas team's trading at HSC and Katy in the investigative period. Barnhart's interview was on December 17, 2008, after she returned from a two-week vacation with a similar result.

[189] After BP Compliance provided a synopsis of the trader interviews, the CFTC informed BP that it did not want any re-interviews of the traders. Several times during the investigation, counsel requested and received permission from Enforcement to speak to the traders to respond to data requests.

that, "In summary, ISTC found no regulatory breaches or violations of internal BP policies."[190] However, due to blatant deficiencies in data collection and analysis, the report missed obvious markers of the manipulation.

First, the Compliance report did not examine any November trading data despite Luskie's direct reference in the recorded call to what the Texas team was doing "this month." Simmons could not explain this omission.[191] In addition, although Simmons understood that Luskie was referring to the Texas team traders when he said what "we" were doing at HSC this month in the recorded call, the Compliance report failed to break out the Texas team's trading from the total SEGT positions. Thus, the Compliance report missed the Texas team's effort to reduce SEGT's total short physical position at HSC in these months.[192]

Similarly, the Compliance report did not examine the PnL on the Texas team's financial position at HSC or the directionality and timing of the Texas team's fixed-price trading at HSC.[193] Thus, the report did not catch the explosion in the profitability of the Texas team's HSC-Henry Hub spread position or the shift to heavy, early selling at HSC after Hurricane Ike. Moreover, although the report states that analyzing intraday price changes would be the best way to determine if the Texas team engaged in uneconomic selling at HSC, the report contains no such analysis.[194]

[190] The lack of caveats in the report indicates that BP Compliance did not believe the CFTC's restriction to a single interview of the traders or the CFTC's and Enforcement's contributions to the interview questions hampered its ability to conduct the inquiry. BPL F2 00017942 ("The Compliance report").

[191] Simmons acknowledged that the Texas team's November physical and financial positions would have been set up in advance of the recorded call. Simmons claimed that Compliance examined more trading data than appears in the report but he could not testify what was reviewed or why it was not included. Simmons Dep. at 221:4-9.

[192] Simmons admitted that to drive HSC prices lower, a trader would want a smaller physical short position there. Simmons Dep. at 215:7-8.

[193] Simmons Dep. at 225:6-14.

[194] By failing to examine the Texas team's monthly financial positions at HSC, the report missed the increase in the Texas team's HSC-Henry Hub financial spread position for October and November and Comfort's role in creating these larger financial positions. The report provides SEGT's financial position at HSC on a single day – September 18, 2008 – to determine whether SEGT's financial position on that day was leveraged. Simmons conceded that nothing prevented Compliance from determining the amount of

Second, the analysis of the trading data in the report was so cursory that Compliance missed additional markers of the manipulation. For example, although the Compliance report contains a graph of SEGT's fixed-price trading at HSC from August 1, 2008 through October 31, 2008,[195] the report failed to note the marked increase in SEGT's fixed-price volume at HSC after Hurricane Ike, even though Simmons admitted that this increase is visually apparent.[196] Nor does the report discuss why SEGT utilized 95 percent or more of the HPL capacity so frequently after Hurricane Ike.[197] Together, the omission of obviously relevant data (such as the November positions) and the cursory nature of the analysis led staff to question whether BP's Compliance staff ever intended to conduct a meaningful review of Luskie's concerns, or if instead, the inquiry and the report were an effort to quickly dispose of Luskie's concerns and avoid responsibility for the Texas team's activities.

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leverage over the entire period and that Berry had asked in an email for an analysis of the relationship of physical to financial positions for the days on which HPL transport had been "out of the money," but analysis of the rest of these days was not included in the report. Moreover, even the report's conclusion about September 18, 2008 was incorrect. The report notes that SEGT was short both financially and physically at HSC on this day but claims that "a short position would not benefit from a lower Gas Daily price." Compliance report at 14. In fact, both a short financial and a short physical position at HSC would have benefited from lower Gas Daily prices.

[195] Simmons could not explain why this period was chosen for study. Simmons Dep. at 198:24-199:28.

[196] Simmons Dep. at 217:7-219:12; 229:1-12. Similarly, the Compliance report has a column that shows SEGT's bid week activity at HSC, which averaged 1.3 percent to 3.95 percent from August to October and then jumped to 20.48 percent for November. The report claims that the increase can "partly be explained" by lower Platt's volume and possibly by the credit crisis and a weather event but offered no proof for these contentions. At his deposition, Simmons could not explain why this jump in November bid week activity in October and Luskie's comment about "this month" did not spark concern about the Texas team's November financial position. Simmons Dep. at 210:7-16.

[197] Nor could Simmons recall any effort to analyze whether there was a relationship between the post-Hurricane Ike increases in SEGT's fixed-price volume at HSC and HPL utilization and the concerns raised by the Luskie recorded call. Simmons Dep. at 219:13-16.

VII. Legal Findings: BP Violated Section 1c.1

This Part explains how this manipulative scheme violated the Commission's prohibition on market manipulation.

A. Applicable Rule: 18 C.F.R. Section 1c.1

Staff has concluded that the Texas team's actions violated the Commission's anti-manipulation regulation, 18 C.F.R. § 1c.1 (2012), and the Natural Gas Act, § 4A, 15 U.S.C. § 717c-1. The Commission's anti-manipulation regulation prohibits any entity from: (1) using a fraudulent device, scheme or artifice, or making a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule or regulation, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity; (2) with the requisite *scienter*; (3) in connection with a transaction subject to the jurisdiction of the Commission.[198] Fraud is a question of fact that is to be determined by all the circumstances of a case.[199] Proof of *scienter* can be inferred from circumstantial evidence.[200]

B. The Texas Team Implemented a Fraudulent Scheme to Suppress the HSC Next-day, Fixed-Price Market

Staff concluded that the Texas team employed a fraudulent scheme to manipulate the spread between the HSC *Gas Daily* index and the Henry Hub *Gas Daily* index to benefit its financial position.[201] As discussed above, Luskie outlined the manipulative

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[198] The Energy Policy Act of 2005 (EPAct 2005) added an anti-manipulation provision to the Natural Gas Act, 15 U.S.C. § 717c-1, which the Commission codified in Order No. 670. *See Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202, *reh'g denied*, 114 FERC ¶ 61,300 (2006) (Order No. 670).

[199] Order No. 670 at P 50.

[200] *See Herman & Maclean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983) ("proof of scienter required in [securities] fraud cases is often a matter of inference from circumstantial evidence"); *see also United States v. Flynn*, 196 F.3d 927, 929 (8th Cir. 1999) (upholding conviction in an SEC Rule 10b-5 securities fraud case, the court noted "[f]raudulent intent need not be proved directly and can be inferred from the facts and circumstances surrounding a defendant's actions"); *Wechsler v. Steinberg*, 733 F.2d 1054, 1058 (2d Cir. 1984) ("Proof of scienter need not be direct, but may be a matter of inference from circumstantial evidence").

[201] *See Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001) (holding that open market transactions can constitute market manipulation if done with a manipulative scheme in the recorded call and staff corroborated his roadmap by examining the Texas team's trade and transport records.

First, the Texas team's increases to its physical long positions at Katy and HSC were consistent with the scheme's need to have a steady supply of physical gas each day to use to suppress the fixed-price market at HSC. Second, Luskie's suspicion in the recorded call that the Texas team was selling at HSC to affect the index is confirmed by the significant and unexplained changes in the Texas team's physical trading. In particular, the shift from alternatively buying and selling at HSC to becoming an exclusive net seller of fixed-price gas was inconsistent with the Texas team's stated arbitrage strategy and had no discernible market-based explanation. The significant increases in the Texas team's fixed-price sales, fixed-price sales concentration, and heavy, early selling at HSC establishes that the Texas team's trading sent false signals to the market about supply and demand at HSC.

The Texas team's fixed-price sales at HSC below both HSC and Katy daily prices is also evidence that the Texas team was manipulating the market.[202] Moreover, the fact that bid and offer data show that over eighty percent of the Texas team's sales at Katy were economic under the arbitrage strategy versus only fifty percent at HSC confirms that the Texas team traders were frequently failing to sell at HSC in response to supply and demand conditions.

C. The Texas Team Acted with *Scienter*

Staff also concluded that the Texas team acted with requisite scienter when it sold fixed-price gas at HSC to suppress the HSC *Gas Daily* index. First, the recorded call reveals that the Texas team traders were knowingly selling physical gas to benefit their financial position. And without question, the traders knew that the team's swing spread benefitted the wider the spread between the two *Gas Daily* indices settled, that bringing more supply to HSC would lower prices, and that their access to real-time trading data showed them how their physical gas trades at HSC were affecting the developing HSC VWAP.[203] They also knew when their sales at HSC did not meet or exceeded the variable cost to transport their Katy gas to HSC.

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purpose); *SEC v. Masri*, 523 F. Supp. 2d 361, 372 (S.D.N.Y. 2007) (holding that open market purchases made with the intent to artificially affect the price of a security can constitute market manipulation and that other deceptive conduct, although not required, can be used to prove manipulative intent).

[202] *Brian Hunter*, 135 FERC ¶ 61054 (2011) at 10.

[203] Comfort Dep. Vol. III at 477:14-478:21; Luskie CFTC Dep. at 128:9-11 (explaining that if you put on a spread between HSC and Henry Hub that was "50 cents

With all of this knowledge, the Texas team traders continued to trade heavily and early at HSC, and chose to increase their November physical long positions at Katy and HSC, even though they knew that their new pattern of HSC selling was proving to be less economic. Moreover, in the recorded call in November, Comfort was unable to explain coherently why the team's uneconomic selling at HSC and "packing the pipe" was anything other than an attempt to manipulate the HSC index.

Despite Comfort's later denials, the motivation for the Texas team's uneconomic trading lay in their expectation of benefits to their financial position. As shown above, the Texas team traders saw the potential profit explode on their swing spread in September 2008 after Hurricane Ike. In response, the traders immediately increased their fixed-price selling at HSC, and later altered their physical and financial positions at HSC and Katy to allow them to continue to profit from the manipulation in October and November 2008. Their intent to manipulate the physical market to benefit the financial position also explains the Texas team's indifference to selling physical gas at HSC to capture real-time price spreads between Katy and HSC in this period.

Lastly, an economic motive can also be evidence of intent to manipulate.[204] In this case, the traders understood their bonuses were based in part on the profits their team's position generated.[205] Because the financial positions had much greater upside than the potential losses on the physical trading, a financial motive was clearly present. Comfort, in particular, had strong personal motives for the Texas team to have a

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back," then you "would like to see . . . [HSC] cash trade further bank [sic] of the Hub than that 50-cent level"); Comfort Dep. Vol. II at 377:11-17; Comfort Dep. Vol. III at 519:13-17 (explaining that he used the Katy-HSC spreadsheet to monitor the formation of the index); Comfort Dep. Vol. III at 518:16-519:17 (explaining that he monitored the formation of the *Gas Daily* index and incorporated it into a cell in the Katy-Ship Excel sheet).

[204] *Markowski*, 274 F.3d at 528; *see also Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 795 (2d Cir. 1969) (manipulative purpose is prima facie established where a person who has a "substantial, direct pecuniary interest in the success of a proposed offering takes active steps to effect a rise in the market in the security.") (quoting *3 Loss, Securities Regulation*, 1552-53 (2d ed. 1961) (internal citations omitted)) *aff'd in part and rev'd in part on other grounds sub nom. Crane Co. v. American Standard, Inc.*, 603 F.2d 244 (1979).

[205] Barnhart Dep. at 189:9-11; Luskie CFTC Dep. at 111:15-17; Comfort Dep. Vol. II at 248:11-14. Comfort and Barnhart both received substantial bonuses in 2009 for their performance in 2008-09. Salary and Bonus Information at BP-L F2 0002.xls.

profitable year and he made the overwhelming bulk of the manipulative physical sales.[206]

For all these reasons, staff concluded that the Texas team traders had the intent to suppress the HSC *Gas Daily* index to benefit the Texas team's swing spread position.

D. BP Acted in Connection with a Jurisdictional Transaction

The Texas team's scheme to suppress HSC physical gas prices during the investigative period falls within the Commission's jurisdiction. BP's trading of physical natural gas at HSC involved Commission-jurisdictional wholesale natural gas sales, namely, wholesale natural gas sales in interstate commerce that are not "first sales" within the meaning of the NGPA.[207]

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[206] Staff finds the evidence also establishes, at the very least, that the Texas team acted recklessly with regard to the impact of its trading the HSC *Gas Daily* index. Recklessness may satisfy the element of *scienter*. Order No. 670 at P 53 (citing *Florida State Board of Administration v. Green Tree Fin. Corp*., 270 F.3d 645 (8th Cir. 2001). An entity may engage in reckless conduct through willful blindness or ignorance of the effect of its actions. In the context of the Securities Exchange Act's Section 10(b) on which the Anti-Manipulation Rule was modeled, recklessness may be found if there is a danger "so obvious that the actor must have been aware of the danger." *See Amaranth Advisors, L.L.C.*, 120 FERC ¶ 61,085, at P 112 (2007).

[207] The NGA, Supreme Court decisions, and Commission orders (supported by the legislative history of the Natural Gas Wellhead Decontrol Act of 1989) authorize the Commission to examine and consider non-jurisdictional first sale transactions, to determine whether a fraudulent or manipulative scheme, device, or artifice has been employed to manipulate a natural gas market. The manipulative or fraudulent scheme, however, need not be subject to the Commission's NGA jurisdiction. If the Commission establishes that the scheme was "in connection" with NGA jurisdictional sales, purchase or transportation, and scienter is found, the entity engaged in the fraudulent or manipulative conduct will have violated Section 1.c of the Commission's regulations. Staff finds that BP's trading of jurisdictional and first sale gas at HSC and Katy was in connection with jurisdictional transactions, because BP's sales artificially altered the HSC *Gas Daily* indices, which affected the jurisdictional purchases or sales of other market participants. Order 670, 114 FERC ¶ 61,047 at P 21-22 (2006).

VIII. Sanctions

A. Civil Penalty Recommendations

1. Seriousness Factors

BP's violations fall under the Penalty Guidelines' Chapter Two guideline for tariff and regulation violations (§ 2B1.1). The Penalty Guidelines consider the gain to the organization or the loss caused by the violation, and the amount of energy involved in the violation, or the duration of the violation, whichever is greater. The following findings relating to the seriousness of BP's violation guide staff's application of the Chapter Two guideline:

- BP's violation resulted in a loss of $9,480,600.[208]
- BP's violation involved more than 700,000 MMBtu of natural gas.

2. Culpability

The Penalty Guidelines consider a variety of factors to derive a culpability score. The following findings relate to BP's culpability and guide application of the Penalty Guidelines to derive a culpability score:

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[208] The pecuniary losses caused by BP equal the summed open interest of physical gas (at HSC and Katy) and financial index swaps at HSC for the period of September 19, 2008 through November 30, 2008 multiplied by the price distortion resulting from the Texas team's fixed-price trading. Staff used the sum of all index and fixed-price physical gas for next-day delivery that were transacted on ICE and financial index swaps that cleared through ICE as its estimate of open interest. Staff's estimated price distortion of $0.06 reflects the average price movement over the month of October that the Texas team needed for the costs of the physical manipulation to be recouped by gains on the financial position – i.e., the break-even point. October was chosen for deriving the price movement caused by the manipulation because, unlike September, October offered a full-month of data and was not affected by the hurricane. Moreover, the decision to continue the manipulation into November was made at the end of October, when the Texas team could evaluate if its manipulative efforts had been successful in the month. Conservatively, staff did not apply the $0.06 price distortion to: (a) bilateral deals that were not done on ICE; (b) volumes from other sources; (c) costs to volumes in pipes that would have moved but for manipulated prices; (d) other volumes that might have come to HSC because the price was artificially low; (e) commercial contracts that were fixed to the HSC or Katy indices; (f) any gas diverted from Katy because of the manipulated price at HSC; and (g) business decisions that were based on the manipulated prices.

- BP has a prior history within five years of an adjudication of similar misconduct by another enforcement agency.[209]
- BP violated an order directed specifically at BP.[210]
- BP did not engage in obstruction of justice.
- BP self-reported.[211]
- BP fully cooperated with the investigation.
- BP had an effective compliance program but did not apply its compliance program and ethics program with sufficient seriousness and failed to conduct a credible internal inquiry into the Luskie recorded call.[212]

Therefore, staff recommends a civil penalty of $28,000,000.

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[209] *See Commodity Futures Trading Commission v. BP Products North America, Inc.*, 1:06-cv-03503 (N.D. Ill. Oct. 25, 2007); *United States v. BP America Inc.*, 07-cr-683 (N.D. Ill. Oct. 25, 2007).

[210] *Id*. (The order permanently restrained, enjoined and prohibited BP from violating the Commodity Exchange Act or "manipulating the price of any commodity in interstate commerce . . . .").

[211] After Comfort and Luskie reported the recorded call to BP Compliance, BP Compliance immediately notified BP's Monitor who reported the incident to the CFTC. The CFTC notified Enforcement. Because BP followed its compliance protocol put into place by the Department of Justice and that process led to a prompt reporting, BP should be given self-report credit.

[212] Companies may receive partial credit for "effective, yet imperfect, compliance programs." *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216 (2010) (Penalty Guidelines) p.4. BP did have a significant compliance program but deficiencies contributed to the failure to prevent and detect the scheme. For example, Compliance did not regularly review the Texas team's position reports, PnL, or transport utilization. Nor was there any heightened review when the traders were selling fixed-price gas at a location where they had a financial position for the month. Compliance failed to flag the suspicious changes in the Texas team's trading patterns at HSC and its utilization of the HPL transport. Most important, the Compliance inquiry and report on the Luskie recorded call was so facially deficient that staff questions whether it was BP's intent to conduct a thorough and honest review of the Texas team's trading at HSC and its use of the HPL transport. In light of these facts, only a 1-point credit is appropriate.

B. Disgorgement for BP

Staff calculated the unjust profits attributable to the Texas team's financial position to determine disgorgement.[213] The calculation for unjust profits includes volumes for September 18, 2008 through November 30, 2008. Consequently, staff intends to seek disgorgement of $800,000 in unjust profits, plus interest, gained from its participation in the HSC physical market on or about September 18, 2008 through November 2008.

IX. Conclusion

For the above reasons, staff recommends that the Commission direct BP to show cause why they have not violated section 1c.1 of our regulations, which prohibits the manipulation of natural gas prices. Staff further recommends the Commission direct BP to show cause why it should not be assessed civil penalties for these violations of $28,000,000 and be required to disgorge $800,000 in unjust profits**.**

[213] Staff also assumed a conservative $0.06 impact on the HSC *Gas Daily* index over the course of the investigative period to calculate the disgorgement amount. *See, e.g., Transcon. Gas Pipe Line Corp. v. FERC*, 485 F.3d 1172, 1176-77 (D.C. Cir. 2007); *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986) (FERC has broad authority to fashion equitable remedies).

Appendix A

Appendix A_hillb6_G.WAV_4CE.wav

This audio file can be located on e-Library

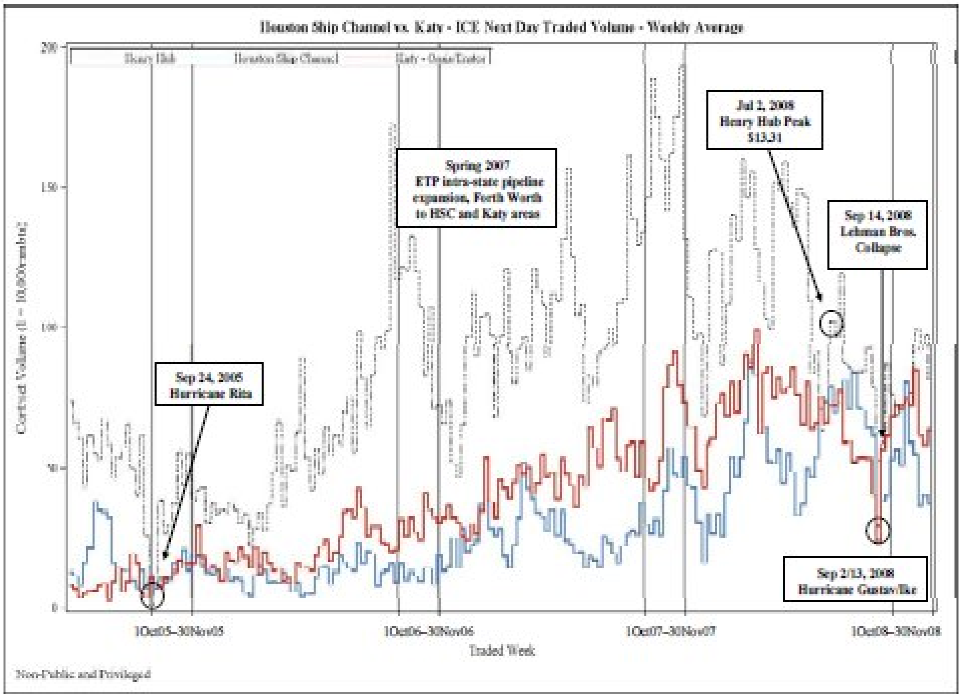
Appendix B

Transcription of Voice Recording
Speakers: Gradyn Comfort and Clayton Luskie
Date of Conversation: November 5, 2008, 11:16 a.m.
Recording Number: hillb6_G.WAV_4CE.WAV
Non-Public

COMFORT: Gradyn here.
LUSKIE: Hey Gradyn, it's Clayton.
COMFORT: Hey bud.
LUSKIE: How's it going?
COMFORT: I'm doing well. How are you?
LUSKIE: I'm doing pretty good.
COMFORT: Yeah good.
LUSKIE: So far everything's going pretty smoothly.
COMFORT: I hear.
LUSKIE: Um, hey, I, need a, I need some help though on something.
COMFORT: Yeah, what do you need?
LUSKIE: Um, so I was trying, you know Jim Parker from Calgary?
COMFORT: I certainly do.
LUSKIE: So I was talking to him and he was just kind of asking, well first of all he started out saying that one of the things he'd like to see more in AGP is that we take more, um, um, sizeable positions into cash off of index and we just be a little more active on our index trading, so I was trying to tell him, you know…
COMFORT: [Laughs]…okay.
LUSKIE: So I was telling him how we, you know what, what we were doing at Ship Channel this month and you know he just started asking me about you know what, kind of, what we do, and strategy and what not, and I was telling him about our HPL transport and the way I explained it was not very good and I came off sounding like we either we transport or don't transport solely on the um, kind of the, the … how we think it's going to affect the index and help our paper position, which as I was explaining I realize that's not right and that's the exact same thing that we're sort of kind of accusing [Company A] of currently. So how would you explain our, um, our dealings on HPL and with our paper position that don't make it sound like we're manipulating the index?
COMFORT: [Interrupts] Clayton, Clayton…
LUSKIE: Yeah.
COMFORT: Clayton, um, I, I think … [pause, sighs] most of the time we ship economically.
LUSKIE: Right.

COMFORT: And uh, the um…
LUSKIE: I mean it's just that we're not…
COMFORT: [Interrupts] Clayton, Clayton…
LUSKIE: Yeah
COMFORT: You know, the, the, the, there's times we, we, we can't unwind all of our positions but most of the time we tend to ship economically.
LUSKIE: Right.
COMFORT: Okay?
LUSKIE: Is it just that we're not…
COMFORT: [Interrupts] Clayton…and then um, the um, the um aspects that go into cash I think are um, are multiple and uh … [pause, sighs]…just give me a second here okay?
LUSKIE: Yeah.
LUSKIE: Hey, I tell you what, I need to actually, I need to run.
COMFORT: Yeah.
LUSKIE: Can I call you back?
COMFORT: Yeah that'd be a good idea.
LUSKIE: Okay.
COMFORT: Okay, thanks.

Appendix C



Houston Ship Channel vs. Katy - ICE Next Day Traded Volume - Weekly Average
Henry Hub
Houston Ship Channel
Katy - Oasis/Enstor
Jul 2, 2008
Henry Hub Peak
$13.31
Spring 2007
ETP intra-state pipeline
expansion, Forth Worth
to HSC and Katy areas
Sep 14, 2008
Lehman Bros.
Collapse
Sep 24, 2005
Hurricane Rita
Sep 2/13, 2008
Hurricane Gustav/Ike
200
150
100
50
0
1Oct05–30Nov05
1Oct06–30Nov06
1Oct07–30Nov07
1Oct08–30Nov08
Traded Week
Non-Public and Privileged

Appendix D

From: Berry, Michael
Sent: Tuesday, November 18, 2008 11:12 AM
To: Simmons, Steve
Subject: Re: FYI - Joan Manley and HSC

I will want to talk to luskie on thursday. Set up a time with mary. I have something more fulfilling in mind
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Sent from my BlackBerry Wireless Device

----- Original Message -----
From: Simmons, Steve
To: Berry, Michael
Sent: Tue Nov 18 16:09:39 2008
Subject: RE: FYI - Joan Manley and HSC

I don't know. Hopefully it can be a phone call.

Mrs. Quigley and I will step up our efforts on this - esp. given the 'new' audience.

Rick said he would let us know when the meeting would be and what was needed. He also asked to be kept in the loop on our progress. If you have time, I'd just give him a quick call.

- Steve

p.s. - taking Luskie outside after lunch to run sprints and do push-ups until he pukes! :)

-----Original Message-----
From: Berry, Michael
Sent: Tuesday, November 18, 2008 10:04 AM
To: Simmons, Steve
Subject: Re: FYI - Joan Manley and HSC

Does this mean I am in washington on friday or monday?

Sent from my BlackBerry Wireless Device

Original Message
From: Simmons, Steve
To: Berry, Michael
Cc: Galicia, Mark A; Sterba, Lisa; Quigley, Helen (NAGP Trading)
Sent: Tue Nov 18 15:50:01 2008
Subject: FYI - Joan Manley and HSC

I just spoke to Mr. Cape. He said that during a routine meeting with the CFTC, Mr. Schwartz mentioned the HSC/HPL inquiry.
Joan now wants to have a meeting with us ASAP. I told Rick what all we had been working on and how it was progressing.
He mentioned that the meeting may have to be on Friday or Monday.

- Steve

Stephen Simmons

File Appendix Aa_hillb6_G.WAV_4CE.WAV cannot be converted to PDF.

Document Content(s)