UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of	:	**CFTC Docket No. 08-01**
PAUL K. KELLY	:	**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 6(c) AND 6(d), 9(a)(2) OF THE COMMODITY EXCHANGE ACT, AS AMENDED, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS**
Respondent	:	

I.

The Commodity Futures Trading Commission ("Commission") has reason to believe that Paul Kelly ("Kelly") has violated Sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act, as amended ("Act"), 7 U.S.C. §§ 9, 13b, 13(a)(2) (2002). Therefore, the Commission deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether Respondent Kelly has engaged in the violations as set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Kelly has submitted an *Offer of Settlement* ("*Offer*"), which the Commission has determined to accept. Without admitting or denying any of the findings of fact or conclusions of law, including the bases for such findings or conclusions, Kelly consents to the entry of, and acknowledges service of this *Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as amended, Making Findings and Imposing Remedial Sanctions* ("*Order*").[1]

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[1] Kelly consents to the entry of the Order, the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Kelly does not consent to the use of the *Offer*, or the findings or conclusions consented to in the *Order*, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding under Title 11 of the United States Code in which Respondent is a debtor to enforce the terms of this Order. Nor does Kelly consent to the use of the *Offer* or this *Order*, or the findings or conclusions consented to in the *Offer* or this *Order*, by any other party in any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

The Commodity Exchange Act ("Act") prohibits manipulation and attempted manipulation of the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity. 7 U.S.C. §§ 9, 13b, 13(a)(2) (2002). On October 31, 2002, Paul Kelly attempted to manipulate the price spread between the November 2002 unleaded futures contract and the December 2002 unleaded futures contract.

B. RESPONDENTS

Paul Kelly is an individual residing in New York. Kelly was a trader and the book leader of BP Products North America, Inc.'s ("BPPNA") northeast unleaded gasoline book from approximately January 2001 until early 2005. Kelly is no longer employed by BPPNA.

C. FACTS

The New York Mercantile Exchange ("NYMEX") lists an unleaded gasoline futures contract ("Unleaded Gasoline Contract") for each month of the forthcoming calendar year.

In 2002, any product delivered pursuant to the Unleaded Gasoline Contract was required to generally conform to industry standards for Phase II Complex Model Reformulated Gasoline in accordance with Colonial Pipeline Co. specifications for fungible A grade, 87 octane index gasoline. This type of unleaded gasoline is known as "A's" or "Reformulated Gasoline". Further, during 2002, Reformulated Gasoline had to include 1.67 percent methyl tertiary butyl ether ("MTBE"), a component required pursuant to federal environmental laws. MTBE is a chemical compound that is manufactured by the chemical reaction of methanol and isobutylene. It is one of a group of chemicals commonly known as "oxygenates" because they raise the oxygen content of gasoline.

Unleaded gasoline, including Reformulated Gasoline, was in short supply in October 2002 and early November 2002 for a number of reasons. MTBE was in short supply in October 2002 and early November 2002. MTBE stocks for the United States were at a low point for the year, and Petroleum Administration for Defense District I ("PADD I") stocks were at their second lowest point in two years. As noted above, MTBE was a required component of Reformulated Gasoline.

In late October 2002, all of BPPNA's unleaded gasoline trading, with the exception of the west coast, was handled by the Light Distillate Group of BP Product Supply & Trading in Chicago, Illinois ("Light Distillate Group"). The Light Distillate Group consisted of four trading books: a gulf coast book, a mid-west book, a components book, and a northeast book. During 2002, Kelly was a member of the Light Distillate Group. Kelly was the "northeast book" leader for finished gasoline. Kelly's primary responsibility was to obtain physical, finished gasoline as

well as components for gasoline for BPPNA's northeast commercial needs. He was also responsible for hedging BPPNA's physical position on the NYMEX.

Kelly was well aware of the shortage of unleaded gasoline in October 2002 and early November 2002, and he was aware that there was a shortage of Reformulated Gasoline.

On Friday, October 25, 2002, Kelly wrote in an email addressed to another BPPNA employee:

> Just an update with the spread settling 10.10 we should have a MTM [mark-to-market] gain of 2.5 to 3 million on Monday obviously at this level I wouldn't bank this $$, remember that a lot of the inventory cannot be made into A's so we cannot liquidate **we need this market to hold these** (sic) **kind of value for 7 to 14 days to end up realizing this income.** However, this market does fell (*sic*) genuinely short through the first day of merc delivery.

(emphasis added). Kelly issued this email in adherence to an internal policy that he was not to allow his colleagues to misconstrue a mark to market gain as an actual realized gain.

At 10:58 a.m. on October 28, 2002, Kelly wrote an email stating that:

> we have bought 3000 spreads on thur/fri [], **I plan to keep the pressure up**.

(emphasis added).

October 30, 2002 was a Wednesday and it was also one day before the expiration of the November Unleaded Gasoline Contract. At the start of the trading day the spread between the November and December Unleaded Gasoline Contracts was at 8.38¢. By the close of the day, the spread increased to 9.07¢. On October 30, 2002, one employee had a discussion with another discussing Kelly's anticipated trading activity for that day, saying that Kelly "wants to take about 1300." The employee also stated that Kelly is "trying to hold . . . the A grade price up."[2]

During the day of October 30, 2002, an economist for the Commission contacted various participants in the NYMEX unleaded gasoline futures market, including BPPNA, to determine the intentions of the largest longs in light of the tight unleaded gasoline market, among other reasons. The senior BPPNA representative to whom the Commission economist spoke stated that BPPNA's intention was to take delivery of 1,300 NYMEX November Unleaded Gasoline Contracts. However, the Commission's economist did not speak to Kelly.

By the end of NYMEX's regular trading hours on October 30, 2002, BPPNA was long 1,352 November Unleaded Gasoline Contracts. Thus, BPPNA's long November 2002 futures

[2] "A grade" is another term for Reformulated Gasoline, the grade of unleaded gasoline deliverable on the NYMEX futures contract.

position at the end of the day was approximately the same amount of the November Unleaded Gasoline Contracts that Kelly planned to take delivery of on the next day – expiration day - according to both the BPPNA employee and the BPPNA representative who spoke to the Commission economist.

At approximately 5:25 p.m., October 30, 2002 a BPPNA employee responsible for executing transactions on the NYMEX, sent an email to their west coast trader, stating that Kelly was "going to support the spread tomorrow."

October 31, 2002, was the expiration date for the November Unleaded Gasoline Contract. Despite the fact that BPPNA held a long position of 1,352 November Unleaded Gasoline Contracts – 52 more than its stated commercial need of 1,300 contracts – Kelly bought an additional 720 November Unleaded Gasoline Contracts through the course of the day.

Kelly contends that he did so to meet BPPNA's commercial needs. The Commission finds that this conduct was in furtherance of Kelly's intent to support the November/December price spread.

After Kelly purchased the additional 720 November Unleaded Gasoline Contract, Kelly sold substantially all the contracts he had purchased during the day. The Commission does not contend that Kelly's purchase or sale of contracts actually created an artificial price in the unleaded gasoline market.

D. LEGAL DISCUSSION

Sections 6(c), 6(d), and 9(a)(2) of the Act make it unlawful for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce. 7 U.S.C. §§ 9, 13b, 13(a)(2) (2002). The following elements are required to prove an attempted manipulation: (1) an intent to affect the market price, and (2) some overt act or omission in furtherance of that intent. *See In re Hohenberg Bros. Co.,* [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 at 21,477 (CFTC Feb. 18, 1977); *CFTC v. Enron Corp.*, 2004 WL 594752 (S.D. Tex. 2004); *CFTC v. Bradley*, 408 F. Supp. 2d 1214, 1220 (N.D. Okla. 2005). Importantly, the Commission has explicitly stated that it is ***not*** a requisite element of proof in either a manipulation or attempted manipulation to establish that the accused possessed: "a demonstrated capability of realizing a manipulation;" "a profit motive;" or "a dominant or controlling position." *Hohenberg*, ¶ 20,271 at 21,477 -78.

To prove the intent element of an attempted manipulation, it must be shown that Kelly acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand." *In re Indiana Farm Bureau Cooperative Association*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 at 27,281 (CFTC Dec. 17, 1982); *see also In re Henner,* 30 A.D. 1151, 1181 (1971). For example, in *In re Hohenberg*, the Commission stated that in order to find the respondents liable for attempting to manipulate the price of cotton futures downward, it must appear from the record, or be inferable from the totality of the circumstances, that "respondents intended their actions to have a depressant effect on the market and that they took some action in furtherance of that manipulative intent." *In re Hohenberg,* ¶ 20,271 at 21,478.

The Commission has stated that in assessing whether an accused possessed the requisite intent in a manipulation or attempted manipulation case it is not necessary to prove that an accused:

> knew to any degree of certainty that his actions would create an artificial price. It is enough to present evidence from which it may reasonably be inferred that the accused "consciously desire[d] that result, whatever the likelihood for that result happening from his conduct."

Indiana Farm Bureau, ¶ 21,796 at 27,283 (quoting *United States. v. U.S. Gypsum Co.*, 438 U.S.442 at 445 (1975)).

To prove the "overt act" element of the offense, it must be shown that Kelly performed an act that constitutes a step toward causing or effecting a price or price trend in the market that would not reflect the legitimate forces of supply and demand.

On October 31, 2002, Kelly engaged in conduct with the intent to affect the price spread between the November and December Unleaded Gasoline Futures Contracts.

IV.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, on October 31, 2002, Kelly violated Sections 6(c), 6(d), and 9(a)(2) of the Act, 7 U.S.C. §§ 6(c), 6(d), 13(a)(2) (2002).

V.

OFFER OF SETTLEMENT

Respondent Kelly submitted the *Offer* in which he, without admitting or denying the findings of fact or conclusions of law herein:

A. Acknowledges receipt of service of the *Order*;

B. Admits the jurisdiction of the Commission with respect to all matters set forth in this *Order*;

C. Waives: the filing and service of a complaint and notice of hearing; a hearing; all post-hearing procedures; judicial review by any court; any and all objections to the participation by any member of the Commission's staff in consideration of the *Offer*; any and all claims that he may possess under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000) and Part 148 of the Regulations, 17 C.F.R. §§ 148.1, *et seq.*, (2007), relating to, or arising from, this proceeding; and any claim of Double Jeopardy based upon the institution of

this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;

D. Stipulates that the record upon which this *Order* is entered shall consist solely of the findings contained in this *Order* to which Kelly has consented; and

E. Consents, solely on the basis of the *Offer*, to entry of this *Order* that:

1. makes findings by the Commission that Kelly violated Sections 6(c), 6(d), and 9(a)(2) of the Act;

2. orders Kelly to cease and desist from violating Sections 6(c), 6(d), and 9(a)(2) of the Act;

3. orders Kelly to pay a civil monetary penalty in the amount of four hundred thousand dollars ($400,000) within ten (10) days of the date of the entry of this *Order*;

4. orders Kelly to comply with his undertaking consented to in his *Offer* and set forth below in Part VI of this *Order*.

Upon consideration, the Commission has determined to accept Kelly's *Offer*.

VI.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

A. Kelly shall cease and desist from violating Sections 6(c), 6(d), and 9(a)(2) of the Act;

B. Kelly shall pay a civil monetary penalty in the amount of four hundred thousand dollars ($400,000) within ten (10) days of the date of the entry of this *Order*. Kelly shall pay the civil monetary penalty by making electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, the payment shall be made payable to the Commodity Futures Trading Commission, and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Marie Bateman – AMZ-300
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone: 405-954-6569

If payment by electronic transfer is chosen, the Respondents shall contact Marie Bateman or her successor at the above funds address to receive payment instructions and shall fully comply with those instructions. Kelly shall accompany payment of the penalty with a cover letter that identifies Kelly, and the name and docket number of this proceeding. Kelly shall simultaneously transmit copies of the cover letter and the form of payment to 1) the Director, Division of Enforcement, Commodity Futures Trading Commission, at the following address: 1155 21st Street, N.W., Washington, D.C. 20581, and 2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission, at the same address; and

C. Kelly shall comply with the following undertakings set forth in his *Offer*:

1. Kelly shall not apply for registration or claim exemption from registration with the Commission in any capacity, and shall not engage in any activity requiring such registration or exemption from registration, except as provided for in Commission Regulation § 4.14(a)(9) (2006), 17 C.F.R. § 4.14(a)(9) (2006) or act as a principal, agent, officer or employee of any person registered, exempted from registration or required to be registered with the Commission, unless such exemption is pursuant to Commission Regulation § 4.14(a)(9), 17 C.F.R. § 4.14(a)(9) (2006), provided, however, should registration be required for trading in energy-related markets that currently is not subject to registration requirements, Kelly may submit an application for registration to be considered by the Commission.

2. Kelly agrees that neither Kelly nor any of his employees, agents, or representatives shall take any action or make any public statement denying, directly or indirectly, any finding in the *Order*, or creating, or tending to create, the impression that the *Order* is without a factual basis; provided, however, that nothing in this provision affects Kelly's: (i) testimonial obligations; or (ii) right to take appropriate legal positions in other proceedings to which the Commission is not a party. Kelly shall undertake all steps necessary to assure that all of his employees, agents, and representatives under his authority and/or control understand and comply with this agreement.

The provisions of this Order shall be effective as of this date.

By the Commission.

David A. Stawick
Secretary to the Commission
Commodity Futures Trading Commission

Dated: October 25, 2007