
IX. Enron's Manipulation of the Natural Gas Markets, Portions of the Enron Online Black Box Revealed, and Forward Looking Recommendations¹

Background

Financial energy products are used to hedge risk on physical energy products, and the two are interrelated. Physical transaction prices dictate the pricing of financial products, i.e., financial products derive their value from the underlying physical market. The depth and liquidity of financial energy markets are far greater than those of physical markets.

The relationship between financial and physical energy products and the relatively thinner and less liquid physical markets provides opportunities to manipulate the physical markets and profit in the financial markets. This is true regardless of whether the manipulation in the physical market raises or lowers prices for the physical commodity.

This chapter analyzes an experiment to test a manipulation strategy and an actual manipulation by Enron using EnronOnline (EOL). Enron manipulated the price of physical gas upward, then downward. Although the price change in the physical markets was only about \$0.10/MMBtu, Enron profited due to the effect that this small change in the physical price had on its large financial position. Enron earned more than \$3 million from this manipulation.

FERC Staff obtained information indicating that Enron traders potentially manipulated the price of natural gas at the Henry Hub in Louisiana to profit from positions taken in the over-the-counter (OTC) financial derivatives markets (OTC markets). Through interviews, depositions, document review, and data analysis, Staff found substantial evidence corroborating the initial information.² It is Staff's opinion that Enron traders, through transactions falling within the Commission's jurisdiction and authorized through a blanket certificate,

¹This section was prepared by FERC Staff with the assistance of outside consultant Chester Spatt, Mellon Bank Professor of Finance, Graduate School of Industrial Administration, Carnegie Mellon University.

²During the investigation into Enron and EnronOnline, FERC provided the Commodity Futures Trading Commission (CFTC) with access to the electronic databases that FERC Staff relied on to generate the analysis for this and other chapters of the Report. FERC provided the CFTC, Department of Justice (DOJ), and Securities and Exchange Commission (SEC) with a preliminary draft of this Report on March 3, 2003, asking for comments and concerns. FERC then met with the CFTC, DOJ, and SEC on March 10, 2003 to discuss this Report prior to its issuance.