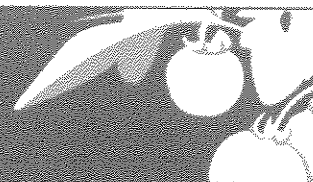


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Did Goldman Goose Oil?

Christopher Helman and Liz Moyer 04.13.09, 12:00 AM ET

How Goldman Sachs was at the center of the oil trading fiasco that bankrupted pipeline giant Semgroup.

When oil prices spiked last summer to \$147 a barrel, the biggest corporate casualty was oil pipeline giant Semgroup Holdings, a \$14 billion (sales) private firm in Tulsa, Okla. It had racked up \$2.4 billion in trading losses betting that oil prices would go down, including \$290 million in accounts personally managed by then chief executive Thomas Kivisto. Its short positions amounted to the equivalent of 20% of the nation's crude oil inventories. With the credit crunch eliminating any hope of meeting a \$500 million margin call, Semgroup filed for bankruptcy on July 22.

But now some of the people involved in cleaning up the financial mess are suggesting that Semgroup's collapse was more than just bad judgment and worse timing. There is evidence of a malevolent hand at work: oil price manipulation by traders orchestrating a short squeeze to push up the price of West Texas Intermediate crude to the point that it would generate fatal losses in Semgroup's accounts.

"What transpired at Semgroup was no less than a \$500 billion fraud on the people of the world," says John Catsimatidis, the billionaire grocer turned oil refiner who is attempting to reorganize Semgroup in bankruptcy court. The \$500 billion is how much the world would have overpaid for crude had a successful scam pushed up oil prices by \$50 a barrel for 100 days.

What's the evidence of this? Much is circumstantial. Proving oil-trading manipulation is difficult. But numerous people familiar with the events insist that Citibank, Merrill Lynch and especially Goldman Sachs had knowledge about Semgroup's trading positions from their vetting of an ill-fated \$1.5 billion private placement deal last spring. "Nothing's been proven, but if somebody has your book and knows every trade, it would not be difficult to bet against that book and put the company into a tremendous liquidity squeeze," says John Tucker, who is representing Kivisto.

What's known for sure is that Goldman Sachs, through J. Aron & Co., its commodities trading arm, was in prime position to use such data--and profited handsomely from Semgroup's fall. J. Aron was Semgroup's biggest counterparty, trading both physical oil flowing through pipelines and paper oil, in the form of options and futures.

When crude oil peaked in July, Semgroup ran out of cash to meet margin requirements on options contracts it had with Aron, contracts on which it had paper losses of \$350 million. Desperate to survive, Semgroup asked Aron to pony up \$430 million it owed on physical oil. Aron said no, declared Semgroup in default on its contracts and demanded immediate payment of losses.

Some answers may emerge in late March when former FBI director Louis Freeh releases a report on the trading surrounding Semgroup's demise. He was hired by Semgroup and given subpoena power by the bankruptcy court judge in Delaware. Meanwhile the Securities & Exchange Commission is investigating, and lawyers involved in the bankruptcy say that Manhattan District Attorney Robert Morgenthau's office is looking into the actions of New York firms in the collapse. His office declines to comment.

Goldman says only that any allegations of oil price manipulation are "without foundation." Merrill and Citi declined

comment.

Goldman and Aron (where Goldman Chief Executive Lloyd Blankfein got his start) have had a deep connection with Semgroup. In 2004 two former Goldman bankers bought a 30% stake in Semgroup for \$75 million through their New York private equity firm, Riverstone. Both men, Pierre Lapeyre and David Leuschen, had helped form Goldman's commodity trading business, and Leuschen had been a director at Aron.

In late 2007 Semgroup entered into an oil-trading agreement with Aron. The companies began trading both oil futures and physical crude. Aron sent much of the oil it bought from Semgroup to a Coffeyville, Kans. refinery in which Goldman owns a 30% stake.

Semgroup's troubles mounted in the first quarter of 2008, when it had to post \$2 billion in margin to cover losses. Goldman offered to underwrite a \$1.5 billion private placement. Kivisto's attorney Tucker and others believe that it was in the Wall Street research for this offering that Semgroup's trading bets became fatally exposed. In April the banks (Merrill Lynch and Citibank were co-underwriters) required that Semgroup submit its trading positions to a stress test, a process one source describes as a "proctology exam." Goldman ended up abandoning the placement as investors balked at braving the liquidity crunch.

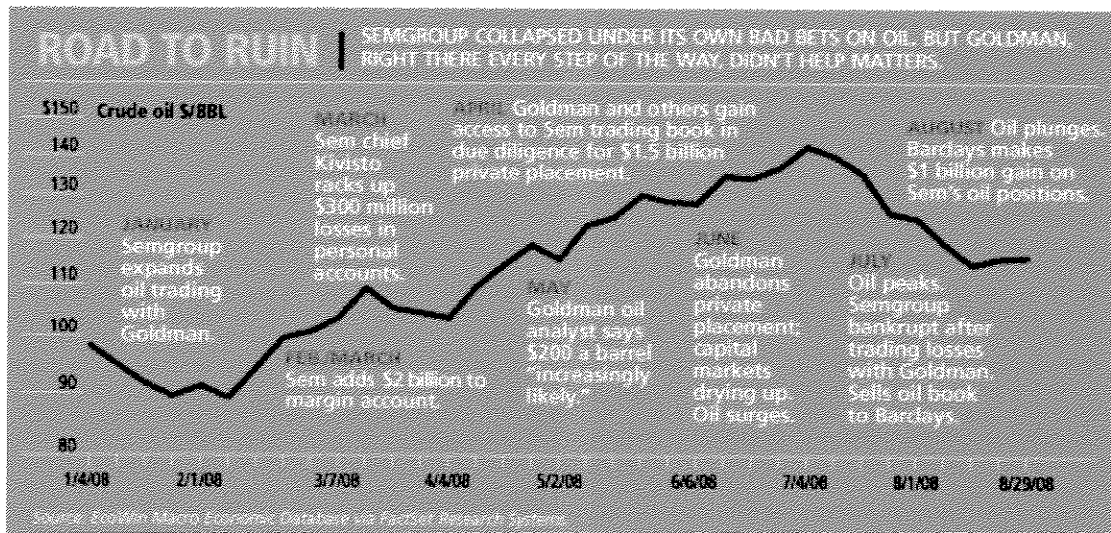
Meanwhile the futures markets had gotten wacky. On June 5, with no news catalysts, oil futures spiked \$5 a barrel, the biggest one-day jump since the outbreak of the first Gulf war. The next day, on no news, the price jumped another \$10 to \$138. Traders say that in the days leading up to the \$147 peak on July 12 there was the smell of blood in the water. "We just kept bidding the market higher," one trader says.

According to a trading summary submitted with court documents, Semgroup had entered into some terribly costly trades with Aron. In February 2008 Semgroup sold Aron call options on 500,000 barrels of oil for July delivery with a strike price of \$96 per barrel. That meant that at the peak Semgroup's loss on each of those barrels was \$51, or \$25.5 million on that trade. Goldman says it "can't comment on the trading positions of counterparties."

Shortly before it filed for bankruptcy, Semgroup sold its trading book to Barclays Capital. Barclays' bold bet was that the price of crude would fall, erasing the losses. It is believed that 30 days later Barclays was sitting on a \$1 billion gain as oil indeed fell, to \$114 a barrel. Barclays wouldn't comment other than to confirm it still owns the book. That prices plunged after Semgroup failed is more evidence of manipulation, says Catsimatidis: "With the portfolio in Barclays' hands they could not squeeze the shorts anymore. The jig was up, and oil collapsed."

Since the bankruptcy, Aron has agreed to pay Semgroup only \$90 million to settle up accounts. That's not enough for the dozens of oil producers who still haven't been paid for \$430 million in oil that Semgroup delivered to Aron. "We sued J. Aron because Semgroup didn't do it," says Phillip Tholen, chief financial officer of oil company Samson Resources. "I can't fathom why they wouldn't file against J. Aron for those monies."

One possible answer: the Goldman connection. Going after Aron's cash would complicate matters with Riverstone, which still wields sway over the board. The creditors have reason to keep Riverstone and Goldman happy; the duo has teamed up to buy myriad energy assets in recent years, most notably a \$22 billion leveraged buyout of pipeline king Kinder Morgan. They are likely to team up again to buy choice Semgroup assets out of bankruptcy.



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