

Class Action Defense Cases—Hershey v. Energy Transfer Partners: Fifth Circuit Court Affirms Dismissal Of Class Action Complaint Under Commodities Exchange Act Holding Plaintiffs Failed To Adequately Allege Specific Intent

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As Matter of First Impression in Circuit, Class Action Claims under CEA (Commodities Exchange Act) Required Allegation of Specific Intent to Manipulate Natural Gas Prices at a Specific Location/for a Specific NYMEX Contract, so District Court Properly Dismissed Class Action Complaint Fifth Circuit Holds

Plaintiffs filed a putative class action against Energy Transfer Partners and its affiliates alleging that they manipulated the price of natural gas futures and options in violation of the Commodities Exchange Act (CEA). *Hershey v. Energy Transfer Partners, L.P.*, ___ F.3d ___, 2010 WL 2510122, *1 (5th Cir. June 23, 2010). According to the allegations underlying the class action complaint, plaintiffs bought and sold natural gas futures and options on the New York Mercantile Exchange (NYMEX), and sought “to represent a class of natural gas futures and options contracts traders.” *Id.* The class action alleged that defendants “manipulate[ed] the price of natural gas delivered at the Houston Ship Channel (‘HSC’) and alleged economic harm to [plaintiffs’] NYMEX natural gas futures contracts caused by that manipulation.” *Id.* Defense attorneys moved to dismiss the class action on the ground that the CEA required plaintiffs to allege that defendants specifically intended to manipulate NYMEX natural gas futures contracts; the district court agreed and dismissed the complaint. *Id.*, at *1, *4. Plaintiffs appealed and the Fifth Circuit affirmed.

We do not here summarize the natural gas futures market. See *Hershey*, at *1-*2. The issue presented, as a matter of first impression in the Fifth Circuit, was whether defendants were correct in arguing that in order to assert a claim under the CEA plaintiffs were required “to allege that Defendants specifically intended to manipulate the price of natural gas” at a specific location (the Henry Hub) thereby satisfying the requirement under the CEA “that the manipulation be specifically directed toward the underlying commodity of the contract.” *Id.*, at *4. And the district court was considering this defense against a backdrop of regulatory action in that defendants previously had paid \$10 million to the Commodities Futures Trading Commission (CFTC) and \$30 million to the Federal Energy Regulatory Commission (FERC) to settle claims that defendants “created and then exploited price differences between the HSC and the Henry Hub, a major confluence of natural gas pipelines and the settlement price for all NYMEX natural gas futures contracts.” *Id.*, *1, *3. Not

surprisingly, plaintiffs' class action complaint "substantially mirror[ed] the allegations in regulatory actions against Defendants by the CFTC and FERC." *Id.*, at *3.

The Fifth Circuit affirmed the district court's dismissal of the class action. The Circuit Court noted that it had not previously "had an opportunity to specifically adopt a pleading standard for commodities manipulation claims," but after summarizing decisions from other circuits it concluded that "the specific intent standard appears to have substantial support." *Hershey*, at *5. The Fifth Circuit concluded, "Because the specific intent standard is grounded in sound reasoning and precedent, we adopt it for private causes of action under the CEA, 7 U.S.C. §§ 13(a) and 25(a)." *Id.* Thus, the Court held that, in order to state a claim under the CEA, plaintiffs were in fact required to allege that defendants specifically intended to manipulate the underlying futures contract at the Henry Hub. *Id.* The Court added that while "no circuit has squarely addressed what constitutes the underlying commodity of a NYMEX natural gas futures * * * [b]y definition, the underlying of a futures contract depends on the contract itself." Accordingly, plaintiffs were required to "allege that Defendants specifically intended to manipulate the underlying of that contract [involving the Henry Hub], not some hypothetical natural gas futures contract." *Id.*, at *6. The Court explained at page *6:

The NYMEX natural gas futures contract is specifically tied to, and standardized against, the spot price at the Henry Hub. Although a party to a NYMEX natural gas futures contract, at an abstract level, deals generally with natural gas, that party may only accept or make delivery at the Henry Hub. This delivery restriction, standard to all NYMEX natural gas futures contracts, leads us to reason that the underlying commodity of a NYMEX natural gas futures contract is not natural gas wherever bought and sold, but the specific natural gas delivered at the Henry Hub.

The Fifth Circuit concluded, "The district court found that a private cause of action under the CEA requires Plaintiffs to plead that (1) Defendants possessed an ability to influence market prices; (2) an artificial price existed; (3) Defendants caused the artificial prices; and (4) Defendants specifically intended to cause the artificial price.... We agree with the district court's finding and adopt this standard for pleading under the CEA's private cause of action, 7 U.S.C. §§ 13(a), 25(a)." *Hershey*, at *7. Based on Circuit Court's review of the pleadings and applicable law, the Fifth Circuit held "Plaintiffs here cannot tie Defendants' manipulation of the HSC price index to an intent or motive to manipulate the Henry Hub price," *id.*, at *8. The Circuit Court explained, "Under a specific intent standard, mere knowledge is not enough; Defendants must have specifically intended to impact the NYMEX natural gas futures market. Plaintiffs here allege only that Defendants knew or should have known that their manipulative actions would depress the NYMEX natural gas futures prices. Therefore, Plaintiffs have not stated a claim under the CEA." *Id.* Accordingly, the Court affirmed the dismissal of the class action complaint, *id.*, at *9.

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