Delta's foray into oil business shows risks

BUSINESS

By Russell Grantham and Kelly Yamanouchi - The Atlanta Journal-Constitution

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Remember when it cost $80 a few years ago to fill up your SUV's gas tank?

Then you may understand why Delta Air Lines went to such lengths to get more control over its $8 billion-plus annual fuel bill. In 2011, it set up a Wall Street-style oil and jet fuel trading desk, and a year later even bought its own refinery.

But those moves came with complications. There was a rocky start to getting the mothballed Pennsylvania refinery running again.

Then there was Jon Ruggles, the man Delta hired in early 2011 to overhaul its money-losing operation to hedge —or provide some level of protection against — big jumps in the price of jet fuel.

This month, Ruggles, 42, was ordered to pay more than $3.1 million in penalties for allegedly profiting on the oil hedges he set up on Delta's behalf. He made a $3.3 million profit by trading against Delta using his wife's account, according to the New York Mercantile Exchange, which levied the penalties and barred Ruggles from the NYMEX market for life.

Delta Air Lines’ efforts to tame its jet fuel bills have added costly complications in recent years. KENT D. JOHNSON /kdjohnson@ajc.com

Ruggles left Delta in late 2012 and did not return calls. There’s no indication any other Delta employees were investigated.

Still, Delta’s experience with its foray into oil trading and the refining business reflect the risks when a business ventures beyond its core.

“This is one where you’ve got a new hire in a new industry that you’re relatively unfamiliar with, you give them responsibility and they abuse that,” said Ernest Arvai, a partner with aviation consultancy AirInsight who is based in Windham, N.H. “That unfortunately happens from time to time, even in the best of organizations.”

William H. Hope, a chartered financial analyst and Atlanta securities lawyer, said Ruggles’ alleged misdeeds are a sideshow to the challenges Delta took on by branching out into complex energy trading and oil refining.

“It appears to me they got sidetracked from their primary business,” he said. “As Ruggles introduced more complicated trading strategies, it looks like Delta went from hedging against increases in fuel prices to speculating in the oil market.”

Ravaged profits

Delta’s moves into the energy trading and refining businesses followed decades of seeing profits ravaged by volatile fuel prices. The airline focused on flying planes and serving customers, only to see sudden spikes in fuel costs or clumsy fuel hedging cost more than $1 billion in some years.

“Delta is hoping to beat Wall Street at its own game by getting into the jet fuel trading business,” Fortune magazine said in an April 2012 article.

The magazine noted that in 2011 Delta had hired Ruggles from Merrill Lynch’s Houston office to straighten out its fuel hedging operation. The energy trader had “extensive experience,” the magazine said, trading oil products at ConocoPhillips, Trafigura and Merrill Lynch.

“He was one of the most charming, engaging speakers I’ve ever had,” recalled Tom Kloza, chief oil analyst at Oil Price Information Service, which tapped Ruggles to speak at its conferences for oil industry players. “This was a coup” for Delta, he thought at the time.

Ruggles arrived at Delta with a $300,000 salary and a $1 million signing bonus, CNBC reporter Kate Kelly wrote in her 2014 book on commodities traders, “The Secret Club that Runs the World,” which has a chapter on Ruggles’ moves at Delta.

Ruggles championed Delta’s move to buy a refinery. When announcing the purchase, then-CEO Richard Anderson thanked Ruggles, along with chief financial officer Paul Jacobson.

Ruggles did well at first with overhauling Delta’s energy hedging operations. One risky bet on heating oil yielded $100 million, enough to push the airlines’s profit-sharing pool into the black, Kelly wrote in her book. Within a year, his trading desk had 20 employees. Ruggles and his wife, Ivonne, bought a $1.75 million home near Chastain Park in 2011.

Appetite for fuel

The trading desk helped meet Delta’s massive appetite for jet fuel, as well as the oil refinery’s need for its raw material, crude oil. Delta CEO Ed Bastian says the refinery supplies roughly 75 percent of the airline’s jet fuel needs around the country.

“We’re the only owner of a refinery … that wants to see fuel prices go down,” Bastian said.

Ruggles also helped trade other refinery products, such as gasoline, for more fuel for Delta’s jets. Only about 30 percent of a barrel of crude oil is made into jet fuel, according to Bastian.

Delta lost money on the refinery initially, as it struggled with damaged pipelines and terminals in the region after Superstorm Sandy and spent months getting the plant fully operating. It also took time for Delta to secure crude oil supplies.

Then, near the end of 2012, Delta got a subpoena from the Commodity Futures Trading Commission, which was looking into the trading operation, according to Kelly’s book.

By year’s end Ruggles was gone.

“Jon Ruggles worked for Delta as a vice president of fuel management from early 2011 through December of 2012,” Delta said in a written statement that was its only comment about Ruggles for this story. “He was terminated by Delta after we became aware of the investigation.”

According to NYMEX’s disciplinary notice released earlier this month, Ruggles in 2012 made 82 trades using his wife's account to profit off his knowledge of the trades he was doing at Delta, which were big enough to move market prices at times. Ruggles' actions violated the exchange's rules and Delta's prohibitions against using the company's confidential information for personal profit, NYMEX said.

'They have to be brilliant'

"Usually when you get someone in this situation, they have to be brilliant to try to pull off what they're doing," said Arvai, of AirInsight. It's "almost impossible to screen out" that type of dishonesty, he said.

Ruggles, who now lives in Montclair, N.J., said the CFTC probe had "zero" to do with his leaving Delta, according to Kelly's book.

Ruggles is in talks with the CFTC to settle its allegations related to the trading, the Wall Street Journal reported earlier this month. The CFTC declined to comment.

Delta has logged record profits in recent years from lower fuel costs, which saved the company almost $1.5 billion in the first quarter of this year.

But it continues to struggle with hedging. Delta logged $118 million in fuel hedge losses from its locked-in contracts in the first quarter, even as crude oil plunged to near $25 a barrel earlier this year, its lowest level in decades. Delta expects more hedge losses in future quarters.

Delta's refinery, meanwhile, became mostly profitable, generating a $290 million profit in 2015 though losing $28 million in the first quarter of this year.

Asked whether Delta would buy another refinery, Bastian said flatly: "No. We're done."

Delta's Trainer, Pa., refinery

Cost: $150 million investment by Delta subsidiary Monroe Energy (named for Delta's original hometown in Lousiana)

Started operations: September 2012

Profits or losses:

$63 million loss, 4th quarter 2012

$116 million loss, 2013

$96 million profit, 2014

$291 million profit, 2015

$28 million loss, first quarter 2016

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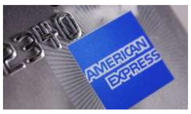

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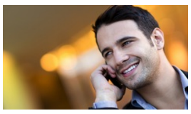

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