UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Up-To Congestion Transactions) Docket No. IN10-5-000

SUPPLEMENTAL SUBMISSION ON BEHALF OF DR. ALAN CHEN

In our prior submission, we note that Enforcement soon will "face a fork in the road." One road—the one we advocate—leads Enforcement to conclude that Dr. Chen engaged in lawful transactions following price signals expressly created by the Commission. The other road—the one we oppose—leads Enforcement to conclude that Dr. Chen engaged in fraudulent market manipulation.

After issuing three data requests and conducting two depositions of Dr. Chen over the course of eighteen months, Enforcement apparently still has not definitively chosen which way to go, though our impression is that Enforcement is leaning sharply towards levying market manipulation charges in this case. As we explain below, that route unavoidably plunges headlong into a very steep chasm—a fall that will be fatal not only to this investigation but also to an entire branch of Enforcement's market manipulation lexicon.

The reason that continued prosecution of this case will throw Enforcement over the proverbial edge is that there is no fraud here. As a result, Enforcement predictably will retreat to the contention that Dr. Chen's trading "impair[ed], obstruct[ed] or defeat[ed] a well-functioning market," and assert that, beyond this, no fraud need be shown. *See Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202 at PP 50 & n.103 (citing *Dennis v. United States*, 384 U.S. 855, 861 (1966)). But as Enforcement will quickly discover, this theory—which we refer to as "non-fraud fraud"—is dead on arrival.

When the Commission adopted its "non-fraud fraud" standard in Order No. 670, it relied solely on a 1960s case, *Dennis v. United States*. *Id.* at P 50 (citing *Dennis*, 384 U.S. at 861). *Dennis* was about a conspiracy to defraud the government, brought under a general conspiracy statute against criminal defendants who were alleged to have fraudulently obtained the services of the National Labor Relations Board on behalf of a labor union by knowingly filing false affidavits denying their affiliation with the Communist Party. The statute in question, 18 U.S.C. § 371, generally prohibits any conspiracy "to defraud the United States, or any agency thereof in any manner or for any purpose."

That exceptionally broad language has long been construed to extend beyond "fraud as that term has been defined in the common law," and to reach "any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of Government." *Dennis*, 384 U.S. at 861 (listing cases). But the federal conspiracy statute differs from common law fraud because it embraces different criminal purposes, *not* because it forbids non-fraudulent conduct. A conspiracy to defraud the government "need not aim to deprive the government of property." *United States v. Caldwell*, 989 F.2d 1056, 1058-59 (9th Cir. 1993) (citing *Haas v. Henkel*, 216 U.S. 462, 479 (1910)). It also "need not involve any detrimental reliance by the

government." *Id.* at 1059 (citing *Dennis*, 384 U.S. at 861-62). Rather than prove reliance, the government, under 18 U.S.C. § 371, "need only show" that a defendant intended "to obstruct a lawful function of the government." *Id*. (citing *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924)).

The Commission's reasoning in Order No. 670 rests on that last point. But it takes that point hopelessly out of context. Fraud was a given in *Dennis*—the communist sympathizers lied about being communists. The Supreme Court has consistently reiterated that prosecution under 18 U.S.C. § 371 is reserved for conspiracies to defraud or obstruct the government through "deceit, craft or trickery, or at least by means that are dishonest." *Id.* at 1058 (quoting *Hammerschmidt*, 265 U.S. at 188); *accord McNally v. United States*, 483 U.S. 350, 358-59 & n. 8 (1987) (same). Any case alleging that someone defrauded the United States must, irreducibly, prove fraud.

More recently, the Ninth Circuit's decision in *Caldwell* flatly rejected the argument that *Dennis* permits the government to punish the "impairment" of a government function without establishing some form of fraudulent conduct. As (now-Chief) Judge Kozinski memorably explained:

> There are places where, until recently, "everything which [was] not permitted [was] forbidden . . . . [W]hatever [was] permitted [was] mandatory . . . . Citizens were shackled in their actions by the universal passion for banning things." Yeltsin Addresses RSFSR Congress of People's Deputies, BBC Summary of World Broadcasts, Apr. 1, 1991, *available* in LEXIS, Nexis Library, OMNI file. Fortunately, the United States is not such a place, and we plan to keep it that way. If the government wants to forbid certain conduct, it may forbid it. If it wants to mandate it, it may mandate it. But we won't lightly infer that in enacting 18 U.S.C. § 371 Congress meant to forbid all things that obstruct the government, or require citizens to do all those things that could make the government's job easier. So long as they don't act dishonestly or deceitfully, and so long as they don't violate some specific law, people living in our society are still free to conduct their affairs any which way they please.

Caldwell, 989 F.2d at 1061; *see also United States v. Knapp*, 25 F.3d 451, 455 (7th Cir. 1994) (noting that *Hammerschmidt* and *Caldwell* "stand for the proposition that a defendant cannot be found guilty of defrauding the United States without some showing of fraud").

So too here. Dr. Chen accurately entered the information necessary to conduct his trades, which were carried out openly. He did not act with any deceit or dishonesty. He did not conceal or misrepresent, or attempt to conceal or misrepresent, anything to PJM or to anyone else. He did not engage in fictitious transactions. He did not make false or misleading representations. In short, he did not engage in fraud. Moreover, what Dr. Chen did do—following price signals expressly created by the Commission—was in full conformance with all governing Commission regulations and PJM tariff provisions. In the words of *Caldwell*, he did not "act dishonestly or deceitfully," and did not "violate [any] specific law." *Caldwell*, 989 F.2d at 1061. That is the end of the analysis.

As Enforcement is well aware, section 222 of the Federal Power Act is based on the Securities Exchange Commission's rule against fraud-based market manipulation. As the Supreme Court has definitively held, that provision may be "aptly described as a catchall provision, but what it catches *must be fraud*." *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980) (stating that section 10(b) of the Securities Exchange Act cannot be read "more broadly than its language and the statutory scheme reasonably permit") (quotations omitted) (emphasis added). Enforcement cannot satisfy that statutory standard in this case.

We renew our request that Enforcement drop this investigation. If Enforcement proceeds with this case, and the Commission issues a show cause order, Dr. Chen will exercise his statutory right to obtain *de novo* review of the facts and law in a federal district court. Consistent with the case law, that court will reject Enforcement's "non-fraud fraud" theory. The lack of any traditional fraud will be fatal to Enforcement's case.

Respectfully submitted,

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