UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

FEDERAL ENERGY REGULATORY COMMISSION,	)	
Plaintiff,	)	
v.	)	Case No. 3:15-CV-00452-MHL
POWHATAN ENERGY FUND, LLC, et al.,	)	
Defendants.	)	

PLAINTIFF FEDERAL ENERGY REGULATORY COMMISSION'S BRIEF IN SUPPORT OF MOTION FOR LEAVE TO AMEND COMPLAINT TO ADD RELIEF DEFENDANTS

Plaintiff Federal Energy Regulatory Commission ("FERC") respectfully seeks the Court's leave, under Federal Rule of Civil Procedure 15(a)(2), to file the attached proposed Second Amended Complaint in this action. *See* Exhibit A. The proposed complaint makes no change to the allegations of manipulative conduct supporting enforcement of the Commission's underlying order. Rather, it would add eight individuals—the current and former investors in Defendant Powhatan Energy Fund, LLC—as "nominal" or "relief" defendants for the sole purpose of effectuating the disgorgement of unlawful trading profits ordered by the Commission against Powhatan. The proposed complaint would also be streamlined to reflect the Commission's recent settlement of its claims against Houlian "Alan" Chen, HEEP Fund, Inc., and CU Fund, Inc.

Under Rule 15(a)(2), when a party seeks leave to amend a pleading, "[t]he court should freely give leave when justice so requires," and justice so requires here. [redacted]

[redacted]

Joining Powhatan's investors as relief defendants will allow the Court to exercise its inherent equitable powers to effect return of ill-gotten funds should it ultimately enter judgment against Powhatan. FERC has promptly sought this amendment [redacted], and complete relief is only possible with such an amendment.

I. FACTUAL BACKGROUND

Defendant Powhatan is a Delaware limited liability company formed in March 2010 by Lawrence Eiben, then an officer and owner of TFS Capital, LLC. Powhatan was created for the specific purpose of investing the personal funds of eight TFS Capital owners and employees in the energy markets. From inception through an unknown date after FERC filed this action, Powhatan's sole and managing member was another Delaware limited liability company called LSE Capital Management, LLC, whose sole member was Mr. Eiben ("LSE" being Mr. Eiben's initials). [redacted]. Collectively, this motion will refer to these eight natural persons as the "Proposed Relief Defendants," and FERC seeks to name them in the proposed Second Amended Complaint, attached hereto as Exhibit A.

After formation and funding, Powhatan invested its money with Dr. Alan Chen pursuant to an advisory agreement between Powhatan and Dr. Chen's firm HEEP Fund LLC. Between June 1, 2010 and August 3, 2010, Dr. Chen's round-trip wash trading in the PJM Interconnection's "Up to Congestion" or "UTC" markets earned Powhatan $3,465,108 in unlawful profits plus interest. The Commission ordered Powhatan to disgorge this amount, and both FERC's initial and First Amended Complaints (ECF Nos. 1 and 93) requested that the Court order Powhatan to disgorge this amount plus interest. The Commission also ordered Powhatan to pay a civil penalty of $16,800,000 plus interest.[1]

[redacted]

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[1] FERC also sought disgorgement from Dr. Chen and entities he controlled, as well as a civil penalty. Dr. Chen and his related LLCs recently settled the Commission's claims, and the Court dismissed them from this suit at the parties' request. *See* ECF No. 249.

[2] [redacted]

[redacted]

[redacted]

[redacted]

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3 [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] *Cf.* ECF No. 93, ¶ 4 (First Amended Complaint alleging June 1 to August 3, 2010 as the time period of Powhatan's fraudulent manipulative trading).

[redacted]

[redacted]

[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]

[redacted]

4 [redacted]

[redacted]

[redacted]

Discovery also revealed that Proposed Relief Defendants Kevin and Richard Gates now exclusively own and control Powhatan and its managing member, LSE Capital Management.[6] They consolidated control within the last five years—after this case was filed—[redacted]. [redacted]

[redacted]

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[6] Consistent with his testimony during the Court's hearing on Williams Mullen's Motion to Withdraw, during his recent deposition Kevin Gates was unable to recall how he owned Powhatan (i.e., directly, via a trust, or some other mechanism). Richard Gates testified similarly during his deposition.

[7] [redacted]

[redacted]

II. ARGUMENT

[redacted]

The proposed amendment's sole purpose is to invoke the Court's inherent equitable power to effectuate the Commission's disgorgement order, and to vindicate the public interest by returning the proceeds of Powhatan's illegal trading to other PJM market participants harmed by that conduct. It alleges no legal claim against the Proposed Relief Defendants, does not propose to make them liable for civil penalties, and adds no new allegations beyond those necessary to recover assets that would be subject to disgorgement if still held by Powhatan. Adding the Proposed Relief Defendants is well within the Court's inherent power to enforce its equitable remedies. FERC's request to do so here is timely and in the interest of justice, would not unfairly prejudice either Powhatan or the Proposed Relief Defendants, and would not require modifying the Court's scheduling order.

A. The Court has Inherent Equitable Power to Order Disgorgement of Unjust Gains from Relief Defendants

Routinely, FERC's counterparts at the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Federal Trade Commission name relief defendants in district court actions alongside culpable actors. It is well-established in the Fourth Circuit and others that "'Federal courts may order equitable relief against a person who is not accused of wrongdoing in a securities enforcement action where that person: (1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds.'" *CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 192 (4th Cir. 2002) (quoting *SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir. 1998)). Here, the Proposed Relief Defendants received unjust gains from the manipulation at issue and do not have a legitimate claim to those funds, making it appropriate to add them to the case for purposes of providing complete equitable relief in the event Powhatan is found liable.

As the Fourth Circuit explained in *Kimberlynn Creek Ranch*, a relief or "nominal" defendant "'is a person who can be joined to aid the recovery of relief without an [additional] assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation.'" 276 F.3d at 191 (quoting *SEC v. Cherif*, 933 F.2d at 414). While the courts have not "developed explicit guidelines for what qualifies as a legitimate claim[,]" it is generally recognized that those "who have provided some form of valuable consideration in good faith" are not subject to disgorgement as relief defendants. *CFTC v. Walsh*, 618 F.3d 218, 226 (2d Cir. 2010). By contrast, those lacking a "legitimate claim" for relief defendant disgorgement purposes include, to name but a few examples, "a bank or trustee, which has only a custodial claim to the property," *SEC v. Colello*, 139 F.3d 674, 677 (9th Cir. 1998); individuals who receive "property as a gift, without the payment of consideration," *Walsh*, 618 F.3d at 226; investors who receive proceeds of the illegal act rather than legitimate returns, *see SEC v. George*, 426 F.3d 786, 798 (6th Cir. 2005); or partners in an investment vehicle who commingle illegal profits with legitimate ones, and disburse amounts to themselves that leave the partnership's total liabilities in excess of its remaining assets, *SEC v. Rosenthal*, 426 F. App'x 1, 3–4 (2d Cir. 2011) (unpublished).

"Because a nominal defendant has no ownership interest in the funds at issue, once the district court has acquired subject matter jurisdiction over the litigation regarding the conduct that produced the funds, it is not necessary for the court to separately obtain subject matter jurisdiction over the claim to the funds held by the nominal defendant; rather, the nominal defendant is joined 'purely as a means of facilitating collection.'" *Kimberlynn Creek Ranch*, 276 F.3d at 191-92 (quoting *SEC v. Colello*, 139 F.3d at 676). A nominal defendant is made "part of a suit only as the holder of assets that must be recovered in order to afford complete relief; no cause of action is asserted against a nominal defendant." *Id.* at 192. The relief defendant's liability for disgorging unjust profits derives from a showing that the wrongdoer himself is liable. *See, e.g.*, *FTC v. AmeriDebt, Inc.*, 343 F. Supp. 2d 451, 464 (D. Md. 2004) ("The Court is satisfied that, if the FTC succeeds in demonstrating Andris Pukke's wrongful obtention of monies [through a fraudulent scheme], it may proceed against his wife [named as a relief defendant] to the extent she received any of those funds.").

The facts in *Kimberlynn Creek Ranch*, which involved a CFTC enforcement action under the Commodities Exchange Act, are instructive. In that case, the CFTC brought suit "against several corporate and individual defendants (collectively, 'the Claim Defendants') alleging that they fraudulently telemarketed illegal futures contracts for precious metals and other commodities." 276 F.3d at 189. The suit also named several relief defendants, "alleging that they held proceeds of the fraud, in which they had no ownership interest, on behalf of the Claim Defendants." *Id.* The district court found that "approximately $2.41 million traceable to the fraudulent activity was deposited into accounts partially or wholly controlled by the Relief Defendants. As a result, "[t]he district court determined that the $2.41 million constituted the proceeds of fraudulent activity and that the Relief Defendants had no ownership interest in the money, *i.e.*, that they were simply holding the money on behalf of the Claim Defendants and had no right to make use of the funds." *Id.* at 190. The district court issued a preliminary injunction freezing the assets of the Relief Defendants, and the Fourth Circuit affirmed. *Id.* at 193.

In so holding, the Fourth Circuit "reject[ed] the Relief Defendants' argument that the injunctive relief ordered exceeded the equitable power of the district court." *Id.* at 193. Finding that the Commodities Exchange Act permitted the CFTC to request, and the district court to order, disgorgement as a remedy, the appeals court concluded that the district court likewise had the power to freeze the relief defendants' "assets in order to preserve the future availability of permanent equitable relief." *Id.* (citing, *inter alia*, *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946) ("[T]he comprehensiveness of ... equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied.").

Though the cases cited herein involving the CFTC, SEC, and FTC involve different statutory schemes than the Federal Power Act, they are congruent with FERC's request here in that they involve an enforcement agency's request that the Court exercise its inherent equitable power to give complete relief in the public interest. *See, e.g.*, *Kimberlynn Creek Ranch*, 276 F.3d at 193 (finding district court's injunction freezing relief defendants' assets within its "inherent equitable powers"). Indeed, in a previous published decision in this case, the Court recognized that FERC "had the authority to order disgorgement, and this Court has the inherent equitable power to affirm or modify that order as to the disgorgement." *FERC v. Powhatan Energy Fund, LLC*, 345 F. Supp. 3d 682, 692 (E.D. Va. 2018) (ECF No. 107, at 13). As the Court recognized, under the Federal Power Act, 16 U.S.C. § 823b, "[t]he Court may enforce the

Penalty Order; modify the Penalty Order and enforce it as so modified; or set the Penalty Order aside in whole or in part. Accordingly, § 823b does not divest this Court of authority it otherwise would have in any other civil action." *Id.* at 698. This Court also recognized that its "'inherent equitable powers . . . assume an even broader and more flexible character' when public—rather than merely private—interests are at stake." *Id.* (quoting *Porter*, 328 U.S. at 398); *see also id.* at 698 ("Absent clear congressional intent to do so, a court will not presume that its equitable power has been limited.").

The same inherent equitable powers that allow the Court to order disgorgement allow it to bring relief defendants into this suit. Furthermore, there is good cause to add the Proposed Relief Defendants for purely remedial purposes. [redacted] They do not have any legitimate claim to funds derived from Powhatan's illegal trading—[redacted] No document provided in discovery suggests the Proposed Relief Defendants provided legitimate goods or services to Powhatan entitling them to retain the distributions. They should therefore be brought into the case for the sole purpose of making any award of disgorgement effective as to Powhatan.

B. Amendment to Allow Adding the Proposed Relief Defendants Should Be Granted Under Rule 15(a)(2).

Under Federal Rule of Civil Procedure 15(a)(2), when a party seeks leave to amend a pleading, "[t]he court should freely give leave when justice so requires." Fed. R. Civ.P. 15(a)(2). "[L]eave to amend a pleading should be denied only when the amendment would be prejudicial to the opposing party, there has been bad faith on the part of the moving party, or the amendment would be futile." *Johnson v. Oroweat Foods Co.*, 785 F.2d 503, 509 (4th Cir. 1986). In the Fourth Circuit and others, "delay alone is not sufficient reason to deny leave to amend. The delay must be accompanied by prejudice, bad faith, or futility." *Id.* at 509-10 (footnote omitted); *see also Edwards v. City of Goldsboro*, 178 F.3d 231, 242 (4th Cir. 1999). None of those issues is present here, and it is in the interest of justice to add the Proposed Relief Defendants to the case to ensure complete equitable relief if Powhatan is found liable.

The sole reason for delay in naming the Proposed Relief Defendants is that [redacted]

Here, the Proposed Relief Defendants would not be prejudiced by naming them to ensure that unjust gains are recoverable. (Nor would any other party be prejudiced.) As the Proposed Relief Defendants are not, by definition, accused of any wrongdoing, their liability is limited to amounts of unlawful profits actually received through Powhatan, and any discovery related to the amount of their disgorgement would essentially be limited to asset tracing. [redacted] Thus, the Proposed Relief Defendants will not be prejudiced. In contrast, without the proposed amendments, FERC's ability to obtain disgorgement and return Powhatan's illegal profits to those harmed by its manipulative trading is uncertain. [redacted]

Moreover, FERC is not acting in bad faith, but, rather, seeks the proposed amendment only to serve the public interest and ensure complete recovery of Powhatan's unjust profits. [redacted] The sole reason for the proposed amendment is to ensure that the proceeds of a wrongful act are recovered to pay the victims of Powhatan's unlawful trading, and for no other purpose.

Finally, the addition of the Proposed Relief Defendants would not be futile. For the reasons discussed above, it would be comfortably within the Court's inherent equitable powers to grant the amendment. And as discussed below, FERC's request is also timely under the statute of limitations period under the relation-back doctrine of Rule 15(c).

C. Under Rule 15(c), the Addition of the Relief Defendants Relates Back to the Filing of FERC's Original Complaint.

[redacted], the request is timely under the relation-back doctrine of Federal Rule of Civil Procedure 15(c). As the Fourth Circuit has explained,

> determining whether an amendment relates back looks at whether the plaintiff made a mistake in failing to name a party, in naming the wrong party, or in misnaming the party in order to prosecute his claim as originally alleged, and it looks into whether the rights of the new party, grounded in the statute of limitations, will be harmed if that party is brought into the litigation. When that party has been given fair notice of a claim within the limitations period and will suffer no improper prejudice in defending it, the liberal amendment policies of the Federal Rules favor relation-back.

Goodman v. Praxair, Inc., 494 F.3d 458, 471 (4th Cir. 2007).

Here, FERC does not propose to assert any "claim" against the Proposed Relief

Defendants at all—it merely asks that they be brought into this suit to ensure the effectiveness of the Court's remedial powers in the event of a disgorgement award. Nonetheless, the standard articulated by the Fourth Circuit in *Goodman* shows that the Proposed Relief Defendants have "been given fair notice" of FERC's claims against Powhatan "within the limitations period and will suffer no improper prejudice," *Goodman*, 494 F.3d at 471, if they are brought into the case for limited remedial purposes.

First, other courts have recognized that it is appropriate to add relief defendants and relate their addition back to a timely filed complaint where an enforcement agency has learned through discovery that a claim defendant has dissipated assets to a relief defendant. *SEC v. Montle*, 65 F. App'x 749, 754 (2d Cir. 2003) (unpublished), is particularly instructive. There, the SEC filed a timely securities fraud action seeking disgorgement, but "was unaware at the time it filed its original complaint" that the claim defendant had purchased a yacht with illegal proceeds and transferred it to two relief defendants. *Id.* The Second Circuit concluded that the omission of the relief defendants from the original complaint could therefore be deemed a mistake for purposes of Rule 15(c), and that relation back was appropriate. *Id.* Amending pleadings to add relief defendants unmasked in discovery ensures complete equitable relief is available in the event of a final judgment against the wrongdoers. *See FTC v. Bronson Partners, LLC*, 2005 WL 7999668, No. 3:04CV1866 (D. Conn. June 8, 2005) (granting leave to amend FTC complaint to add relief defendants "to effectuate complete relief" where discovery showed that claim defendant had transferred "substantial monies" to relief defendants); *SEC v. Breed*, No. 01 CIV. 7798 (CSH), 2003 WL 118494, at *2 (S.D.N.Y. Jan. 13, 2003) (granting leave to amend SEC complaint to add two relief defendants who were found in discovery to have "profited from [the] illegal trading, and that each either has failed to cooperate with, or has actively obstructed, the SEC's discovery effort.”). [redacted]

Second, the Proposed Relief Defendants had “fair notice” of FERC’s claim against Powhatan within the limitations period. They undoubtedly knew of FERC’s investigation from its very inception, [redacted]

Third, the Proposed Relief Defendants will not be prejudiced by being brought into this action for purely remedial purposes. [redacted]

[redacted]

In these circumstances, it can hardly be said that forcing the Proposed Relief Defendants to live up to their promises would unfairly prejudice them.

Adding the Proposed Relief Defendants to the case also need not upset the case schedule or the Court's existing trial date. Once Powhatan's liability for disgorgement is established, due process would allow the Court to use summary procedures to determine each Proposed Relief Defendant's liability for a portion of the amount awarded. Any procedure that permits the Proposed Relief Defendants to present evidence and make arguments regarding disputed facts would likely satisfy due process requirements. *See, e.g.*, *SEC v. World Cap. Mkt., Inc.*, 864 F.3d 996, 1009 (9th Cir. 2017) (approving of "a truncated form of process vis-à-vis relief defendants"; due process satisfied by allowing relief defendants to participate in evidentiary hearings (quotation marks omitted)); *SEC v. Millennium Bank*, No. 7:09-CV-050-O, 2009 WL 10689053, at *3 (N.D. Tex. July 21, 2009) (in adjudicating relief defendant liability for disgorgement, court has discretion derived "from the inherent powers of an equity court to fashion relief" and may use "summary procedures"). Furthermore, any proceeding concerning the disgorgement due from the Proposed Relief Defendants need not involve the jury, because it would concern purely equitable issues.

III. CONCLUSION

The Court should grant FERC leave to file a Second Amended Complaint in the form attached hereto as Exhibit A, adding Kevin Gates, Richard Gates, Lawrence Eiben, Chao Chen, Eric Newman, Mike Frederick, Sam Harris, and Gregory Sekelsky as relief defendants in the action against Powhatan for disgorgement.

Respectfully submitted,

Dated: December 3, 2021

/s/ Kevin Dinan
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CERTIFICATE OF SERVICE

I certify that on December 3, 2021, I filed the foregoing with the Court's CM/ECF system, which caused a copy to be served on counsel of record for all parties to this action.

/s/Kevin Dinan

Kevin Dinan

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

FEDERAL ENERGY REGULATORY COMMISSION,	)	
Plaintiff,	)	Civil Action No. 3:15-cv-0452
v.	)	
POWHATAN ENERGY FUND, LLC,	)	**JURY TRIAL REQUESTED**
Defendant.	)	
and	)	
KEVIN J. GATES, **RICHARD J. GATES,** **LAWRENCE S. EIBEN,** **CHAO CHEN,** **ERIC NEWMAN,** **GREGORY M. SEKELSKY,** **THOMAS MICHAEL FREDERICK,** **and** **SAMUEL C. HARRIS**	)	
Relief Defendants.	)	

SECOND AMENDED COMPLAINT

Plaintiff Federal Energy Regulatory Commission ("FERC" or "Commission"), by and through counsel, brings this action pursuant to section 31(d) of the Federal Power Act (FPA), 16 U.S.C. § 823b (2016), for an order affirming and enforcing the Commission's May 29, 2015 penalty assessment, against Defendant Powhatan Energy Fund, LLC, as set forth in its Order Assessing Civil Penalties, *Houlian Chen, Powhatan Energy Fund, LLC, HEEP Fund, LLC, CU Fund, Inc.*, 151 FERC ¶ 61,179 (2015) (the Penalty Order). The Commission's Penalty Order is attached as Exhibit 1. The Commission also requests that the Order be modified to permit disgorgement of certain unjust profits from eight Relief Defendants who were not named in the Commission's Order, but who have received ill-gotten funds from Powhatan over which the Relief Defendants do not have a legitimate claim. Finally, the Commission no longer seeks enforcement of the Order against Former Defendants Houlian "Alan" Chen, HEEP Fund, Inc., or CU Fund, Inc. (collectively, the "Former Defendants"), who have been dismissed from this lawsuit.

SUMMARY OF THE ACTION

1. This is an action for affirmance and enforcement of civil penalties assessed by the Commission, by order, against Defendant Powhatan Energy Fund, LLC. (Previously, this action sought similar relief against Former Defendants HEEP Fund, Inc., CU Fund, Inc., and against Former Defendant Houlian "Alan" Chen, who executed trades on behalf of Powhatan, HEEP Fund, and CU Fund between June 1 and August 3, 2010 (the Manipulation Period); these parties were dismissed by order of the Court dated November 4, 2021 (ECF No. 29).) The FPA authorizes the Commission to issue orders assessing penalties for violations of the statutes the Commission administers, and the rules, regulations, and orders issued pursuant to those statutes. 16 U.S.C. § 825*o*-1 (2016). The FPA also authorizes the Commission to file this action to seek from this Court "an order affirming the assessment of the civil penalty." 16 U.S.C. § 823b(d)(3)(B). It provides jurisdiction to this Court to enter a judgment affirming, enforcing, modifying, or setting aside in whole or in part such penalty assessments. *Id.*

2. In its Penalty Order, issued on May 29, 2015, the Commission, after examining the arguments submitted by all parties and after reviewing the extensive factual record, found that Powhatan Energy Fund, LLC, HEEP Fund, Inc., CU Fund, Inc., and Houlian

"Alan" Chen (collectively known in the administrative proceeding before the Commission as "Respondents") had manipulated the wholesale energy markets by implementing a scheme involving the execution of large volumes of offsetting trades – wash trades – for the purpose of capturing "excessive amounts of certain credit payments." Penalty Order at P 1.[1]

3. As discussed more fully below, the scheme involved trades of "Up-To Congestion" (UTC), a financially-settled product that allows market participants to hedge costs and arbitrage price differentials. During the Manipulation Period, most UTC trades received a small credit, the Marginal Loss Surplus Allocation (MLSA), described more fully below. The Commission found that Respondents executed a scheme of offsetting, or self-cancelling, UTC transactions which neither hedged costs nor arbitraged price differentials but, instead, were designed to capture the MLSA payments without exposing the Respondents to market prices. These trades were a form of "wash trading," a trading practice the Commission has explicitly prohibited. *Id.* P 6. In addition to being prohibited in FERC-jurisdictional financial markets, wash trading, in its various forms, is generally prohibited in the United States' major financial markets, including those overseen by the Securities and Exchange Commission and the Commodities Future Trading Commission.

4. Specifically, as described in the Penalty Order, the Commission found that

[1] The substantive paragraphs of Commission orders are numbered; ordering paragraphs in such orders are denominated by letter. It is to these paragraphs – designated by capital "P" – that the orders are conventionally cited. Thus, a citation would be made to a substantive paragraph as, e.g., "P 3," or to an ordering paragraph as, e.g., "Ordering P (B)". Plaintiff follows that convention herein.

> [f]rom June 1 to August 3, 2010 (Manipulation Period), Respondents designed and implemented a fraudulent UTC trading scheme to receive excessive amounts of MLSA payments. To do this, Respondents intentionally placed a high-volume of 'round-trip' UTC trades that canceled each other out by placing the first leg of the trade from locations A to B, and simultaneously placing a second leg of equal volume from locations B to A. The contemporaneous evidence shows that Respondents artificially created these round-trip UTC trades solely to reserve transmission service to enable them to collect excessive MLSA payments during the Manipulation Period.

Id. P 3 (footnote omitted).

5. The Commission found that these wash trades constituted "a scheme to engage in fraudulent Up-To Congestion (UTC) transactions in PJM Interconnection L.L.C.'s (PJM) energy markets to garner excessive amounts of certain credit payments to transmission customers" in violation of the FPA's prohibition of market manipulation, 16 U.S.C. § 824v (2016), and the Commission's rule against market manipulation, 18 C.F.R. § 1c.2 (2017). Penalty Order at P 1.

6. Specifically, the Commission concluded, "based on the totality of evidence" that Respondents' round-trip UTC trades,

> operated as a course of business to defraud and a device, scheme, or artifice to defraud the PJM market and market participants . . . . The evidence demonstrates that Respondents placed high-volume round-trip UTC trades without regard to market fundamentals and with the intent to benefit not from the spread on UTC trades but solely from the MLSA payments, and we find those actions to constitute fraud. We also find that Respondents were engaged in wash trading, which the Commission has long recognized as fraudulent conduct. Moreover, we find that the Respondents had notice that the type of trading at issue here is fraudulent and violates FPA section 222 and our Anti-Manipulation Rule.

Id. P 51 (footnote omitted).

7. The Commission issued its Penalty Order on May 29, 2015, following a multi-year investigation conducted by the Commission's Office of Enforcement (Enforcement)

pursuant to the Commission's rules for investigations, 18 C.F.R. Part 1b, and a subsequent contested on-the-record show cause proceeding conducted pursuant to the Commission's rules for hearings, 18 C.F.R. Part 385, in which the Commission acted as a neutral fact-finder. During the adversarial show cause proceeding, Respondents submitted evidence and argument directly to the Commission, including evidence not gathered during the investigation.

8. In determining whether Respondents violated the FPA and the Commission's regulations, the Commission relied upon its interpretation of 16 U.S.C. § 824v, and the Commission's rulemaking adopting regulations implementing Congress' prohibition of manipulation of energy markets. *See Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202 (2006), (adopting 18 C.F.R. § 1c.2 following a notice and comment rulemaking).

9. In assessing and imposing penalties for the violations, the Commission was required to consider and apply statutorily-prescribed criteria, namely, "the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner." 16 U.S.C. § 825*o*-1(b); Penalty Order at P 36. The Commission also considered and applied the non-binding Penalty Guidelines it has adopted to shape its application of these statutorily-prescribed criteria. Penalty Order at PP 149-187.

10. The Commission concluded that, "[i]n light of the seriousness of these violations, we find that it is appropriate to assess civil penalties pursuant to section 316A of the FPA [16 U.S.C. § 825*o*-1(b)] in the following amounts: $16,800,000 against Powhatan; $10,080,000 against CU Fund; $1,920,000 against HEEP; and $1,000,000 against Dr. Chen." Penalty Order at P 1.

11. Additionally, pursuant to section 309 of the FPA, 16 U.S.C. § 825h (2016), the Commission directed disgorgement of unjust profits plus applicable interest in the following amounts: $3,465,108 for Powhatan; $1,080,576 for CU Fund; and $173,100 for HEEP. Penalty Order at P 1. The Commission directed that the disgorged amounts be distributed to market participants who were harmed by Respondents' unlawful scheme. *Id.* at Ordering P (H).

12. Respondents elected to proceed under the terms of FPA § 31(d)(3), 16 U.S.C. § 823b(d)(3), but failed to pay the assessed penalty within 60 days. As a result, the Commission brought this action for "an order affirming the assessment of a civil penalty" before the United States District Court for the Eastern District of Virginia, on July 31, 2015. ECF 1 *and see* Penalty Order at P 193.

13. Pursuant to the FPA, this Court has authority to "review de novo the law and the facts involved, and . . . jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in [p]art, such assessment." 16 U.S.C. § 823b(d)(3)(B). Consistent with the Court's December 18, 2017 Order, Plaintiff filed its First Amended Complaint and asked the Court to affirm and enforce the Commission's penalty assessment without modification.

14. Former Defendants HEEP Fund, Inc., CU Fund, Inc., and Houlian "Alan" Chen were dismissed from this lawsuit by the Court on November 4, 2021 (ECF No. 249).

15. In discovery in this action, the Commission learned that Defendant Powhatan Energy Fund LLC had, in 2010, distributed the proceeds of illegal trading that is the subject of this action to eight individual investors (the Relief Defendants) on condition that the distributed funds remain liquid and available for recall to Powhatan. The

Commission therefore asks the Court to enforce the Commission's Order as to Powhatan against the Relief Defendants liable for disgorgement of ill-gotten funds from Powhatan over which they have no legitimate claim.

PARTIES

A. Plaintiff

16. FERC is an administrative agency of the United States, organized and existing as an independent, bipartisan Commission, pursuant to the FPA, 16 U.S.C. § 791a *et seq.* (2016).

17. For purposes of federal court litigation, FERC is an administrative agency with independent litigating authority. By statute, "[e]xcept as provided in section 518 of title 28, relating to litigation before the Supreme Court, attorneys designated by the Chairman of the Commission may appear for, and represent the Commission in, any civil action brought in connection with any function carried out by the Commission pursuant to this chapter or as otherwise authorized by law." 42 U.S.C. § 7171(i) (2016); *see also*, 16 U.S.C. § 823b(6)(A) ("the Commission may be represented by the general counsel of the Commission (or any attorney or attorneys within the Commission designated by the Chairman) who shall supervise, conduct, and argue any civil litigation to which paragraph (3) of this subsection applies").

B. Claim Defendant

18. At all relevant times, Defendant Powhatan Energy Fund, LLC was a private investment fund organized as a Delaware corporation with its primary place of business

in Henrico, Virginia. The managing member of Powhatan is LSE Capital Management, LLC, a Delaware corporation with its primary place of business in Henrico, Virginia.

C. Relief Defendants

19. Beginning in or about 2010, and continuing to the present, Relief Defendant Kevin J. Gates was an investor in Powhatan. In or about 2010, Kevin Gates received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan

20. Beginning in or about 2010, and continuing to the present, Relief Defendant Richard J. Gates was an investor in Powhatan. In or about 2010, Richard Gates received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

21. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Lawrence S. Eiben was an investor in Powhatan. In or about 2010, Eiben received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

22. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Chao Chen was an investor in Powhatan. In or about 2010, Chao Chen received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan. Relief Defendant Chao Chen is not known to have any familial relation to Former Defendant Alan Chen despite their common surname.

23. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Eric S. Newman was an investor in Powhatan. In or about 2010, Newman received funds

from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

24. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Thomas Michael "Mike" Frederick was an investor in Powhatan. In or about 2010, Frederick received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

25. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Samuel C. Harris was an investor in Powhatan. In or about 2010, Harris received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

26. Beginning in or about 2010, and continuing to an unknown date, Relief Defendant Gregory M. Sekelsky was an investor in Powhatan. In or about 2010, Sekelsky received funds from Powhatan sourced from the trades that are the subject of the Commission's disgorgement order to Powhatan.

JURISDICTION

27. This Court has subject matter jurisdiction over this action pursuant to FPA section 31(d)(3)(B), 16 U.S.C. § 823b(d)(3)(B), which provides that this Court "shall have authority to review de novo the law and the facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in [p]art, such [penalty] assessment" and 28 U.S.C. § 1331 (2016), which provides that "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."

28. This Court has personal jurisdiction over the Claim Defendant and Relief Defendants pursuant to Fed. R. Civ. P. 4(k)(1)(C) in that FPA section 317, 16 U.S.C. § 825p (2012), provides for nationwide service of process and therefore satisfies this subdivision of Rule 4, which provides that "[s]erving a summons or filing a waiver of service establishes personal jurisdiction over a defendant . . . when authorized by a federal statute."

VENUE

29. Venue is also governed by FPA section 317, 16 U.S.C. § 825p (2016), which provides that "[a]ny suit or action to enforce any liability or duty created by . . . this Act, or any rule, regulation, or order thereunder may be brought in [the district wherein any act or transaction constituting the violation occurred] or in the district wherein the defendant is an inhabitant."

30. Venue is established in this district as to the Claim Defendant and all Relief Defendants pursuant to the "any act or transaction constituting the violation" clause of § 825p because the Commission found that that the Claim Defendant engaged in an unlawful scheme to manipulate energy markets in the mid-Atlantic United States, including in this District, from June to August 2010. The Claim Defendant participated in an unlawful scheme that resulted in the misdirection and capture of over $10 million in PJM market payments, including approximately $1,147,087 that would otherwise have flowed to Dominion Virginia Power and inured to the benefit of Dominion and its ratepayers, including ratepayers in this District. Penalty Order at P 68.

31. Furthermore, as to Powhatan, venue is also established in this district based on the "any act or transaction" clause because they entered into an Advisory Agreement[2] (Powhatan Advisory Agreement) pursuant to which Chen, through HEEP, placed the Powhatan trades that the Commission found to violate FPA § 222 and Rule 1c.2. Penalty Order at P 46. In the Powhatan Advisory Agreement, these parties stipulated that, in the event of a dispute arising out of that agreement, legal recourse would be made "only in the courts of the Commonwealth of Virginia, City of Richmond, or . . . in the United States District Court for the Eastern District of Virginia," and states that Powhatan and HEEP "waive any objection to venue laid therein." Powhatan Advisory Agreement at 3. Prior to the Manipulation Period, Chen traded for two of Powhatan's predecessor companies, which were controlled by the same principals, and both of which maintained their principal places of business in the Richmond, Virginia area.

32. Powhatan is also an inhabitant of this District in that it maintains its principal place of business in Henrico, Virginia, within this District.

<u>THE COMMISSION'S ANTI-MANIPULATION AUTHORITY</u>

33. The Commission regulates "'the sale of electric energy at wholesale in interstate commerce,' including both wholesale electricity rates and any rule or practice 'affecting' such rates." *FERC v. Elec. Power Supply Assoc*., 577 U.S. ___ (2016) (*citing* 16 U.S.C. §§ 824(b), 824e(a)). In the wake of manipulative schemes in the western U.S. electricity markets by Enron and others, Congress, through the Energy Policy Act of 2005, expanded the Commission's jurisdiction and amended the FPA to give the Commission

[2] Advisory Agreement between HEEP Fund Inc. and Powhatan Energy Fund LLC (May 18, 2010). The Powhatan Advisory Agreement was submitted to the Court on December 10, 2014 as Administrative Record (AR) item 94.

broad authority to prohibit market manipulation. In relevant part, FPA section 222, 16 U.S.C. § 824v(a), makes it "unlawful for any entity . . . directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy . . . any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers."

34. The Commission implemented this statute in 2006 by promulgating the Anti-Manipulation Rule, which prohibits an entity from: (1) (a) using a fraudulent device, scheme, or artifice, or (b) making a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule, or regulation, or (c) engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity, (2) with the requisite scienter, (3) in connection with the purchase or sale of electricity subject to the jurisdiction of the Commission. 18 C.F.R. § 1c.2 (Anti-Manipulation Rule). As the Commission noted in the Penalty Order, "Under the Anti-Manipulation Rule, fraud includes, but is not limited to, 'any action, transaction, or conspiracy for the purpose of impairing, obstructing, or defeating a well-functioning market.'" Penalty Order at P 35 (quoting *Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202, at P 50 (2006)).

35. The Energy Policy Act of 2005 also provided the Commission with increased civil penalty authority for violations of Part II of the FPA or of "any rule or order issued thereunder." FPA section 316A, 16 U.S.C. § 825*o*-1, authorizes the Commission to assess civil penalties against violators of up to $1 million for each day that a violation

occurs.[3] The Commission has found that each separate transaction that constitutes a violation is subject to a $1 million per day penalty. Penalty Order at P 150 (citing *Barclays PLC, et al.*, 144 FERC ¶ 61,041, at P 120 n.347 (2013); *see also Energy Transfer Partners, L.P.*, 120 FERC ¶ 61,086, at P 69 (2007)). In assessing penalties, the Commission must consider "the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner." Penalty Order at P 151 (quoting FPA section 316A, 16 U.S.C. § 825*o*-1). The Commission's imposition of civil penalties on organizations is also guided by its advisory Penalty Guidelines. *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216 (2010).

BACKGROUND

A. The PJM Market and the UTC Product.

36. Claim Defendant Powhatan, acting through Former Defendants Alan Chen and HEEP Fund, placed the manipulative trades at issue in this case in markets administered by PJM, a Regional Transmission Organization (RTO) that operates a 13-state wholesale organized electricity market stretching from Illinois to North Carolina, and including all of Virginia except a small portion of the southwestern part of the state. Penalty Order at P 15. More than 61 million people depend on the electricity market administered by PJM. PJM, like other organized regional electricity markets in the United States, is established and maintained pursuant to rules established by FERC.[4]

[3] Consistent with the Federal Civil Penalties Inflation Adjustment Act (28 U.S.C. § 2461) (1990) the Commission's civil penalty authority has risen to $1,238,271 per day. *See* 83 Fed. Reg. 1550.

[4] *See generally*, Energy Primer, A Handbook of Energy Market Basics, at 40-41, 58-61 (background on organized regional markets), available at

37. PJM uses market-based systems to provide electricity at the lowest possible cost consistent with maintaining the reliable operation of the grid. To send appropriate price signals, "[e]lectricity prices in PJM vary based on the specific location, or node, within the market." Penalty Order at P 15. Since prices vary by location, market prices for energy at particular nodes are called "Locational Marginal Prices" (LMPs). LMPs are composed of three components: (i) the price of energy, (ii) the cost of congestion, and (iii) the cost of line losses.

38. The first component is the same at every node: the system-wide energy price. This represents the general commodity price for electricity in PJM. It "represents the cost to serve the next increment of load (demand) at a pre-determined reference location." Penalty Order at P 15; *see also* Energy Primer at 60-61 (attached hereto as Exhibit 3).

39. The second component is congestion. Because transmission lines have limited capacity, they can become "congested" in areas where demand exceeds nearby supply. "Transmission congestion occurs when there is not enough transmission capacity for all of the least-cost generators to be selected." Energy Primer at 65. Similar to traffic congestion, bottlenecks can arise on the transmission grid that prevent the flow of the lowest-cost power to demand. Penalty Order at P 15 ("congestion . . . varies at each node depending on the limitations of the transmission system to move power freely between

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http://www.ferc.gov/market-oversight/guide/energy-primer.pdf (visited Jan. 23, 2018) (Energy Primer) (attached as Ex. 3); *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999) (Order No. 2000) (establishing requirements for RTOs); *and see* 18 C.F.R. § 35.34 (Part 35 Subpart F—Procedures and Requirements Regarding Regional Transmission Organizations). The technical protocols governing trading within an RTO are contained in the relevant RTO's Tariff, which must be filed with the Commission. The Commission interprets these Tariffs through its Orders, which arise primarily in the context of contested proceedings between stakeholders, rather than through proceedings in which the Office of Enforcement is a party.

constrained and non-constrained locations"). For example, if the lowest cost generator could only reach load via a 25 MW transmission facility, then it would be able to provide no more than 25 MW, even if the generator were capable of generating more. The remainder of the demand would need to be made up from higher-cost generation that could reach the load in some other way. Congestion typically accounts for the biggest share of difference between LMPs.

40. As for the third component, line losses occur because as electricity travels over the wires some of its energy is lost in the form of heat. So, more electricity must be generated than is ever actually consumed; the cost of the electricity lost to heat (and for which generators must be paid) as energy travels through wholesale transmission lines is the "line loss" component of LMP.

41. "PJM operates a dual settlement market, with both a day-ahead market and a real-time market." Penalty Order at P 16; *and see* Energy Primer at 59-60. In the day-ahead market, market participants engage in transactions involving energy that will flow through power lines the following day (a "day ahead" of the proposed flow date). In the day-ahead market, participants may make bids and offers to buy or sell energy – either physically or "virtually" – for the next day, specifying the quantity, price, location, and hour of delivery. As the Commission has previously noted, "the vast bulk of transactions occur" in the day-ahead market. *Black Oak Energy, LLC v. PJM Interconnection, L.L.C.*, 125 FERC ¶ 61,042, at P 41 (2008).

42. In the real-time market, market participants engage in transactions involving energy that will flow through power lines the same day. The real-time market is also referred to as a "Balancing Market," because one of its functions is to "balance" any

deviations in supply and demand schedules created by PJM based on the day-ahead market transactions. Each LMP settles at a unique price in both the day-ahead and real-time markets, reflecting the combination of the three above-described price components — energy, congestion, and line losses — applicable to that particular node. PJM provides the trading platforms and, with its Internal Market Monitor (IMM), oversees the trading activity.

43. This case involves Up-To Congestion (UTC), a financially-settled "virtual" energy product in PJM. The Commission has recognized that, in wholesale electric markets, virtual products can, in theory, "increase market liquidity, drive convergence between the day-ahead and real-time market, and provide vehicles for hedging." Penalty Order at P 17 (footnote omitted).[5] In other words, the premise underlying virtual trading is that it will bring more participants and their acumen to the market, which will result in more trades at more locations and therefore better price formation, clearer price signals, and ultimately more efficient dispatch (i.e., the selection of specific amounts of energy from specific providers at specific prices).

44. While virtual trades do not result in the physical delivery of power, they are entered into the day-ahead market settlement software and thus impact the rates paid for physical electricity. The Commission had previously found that virtual transactions, including UTCs, were "integrated" into models for pricing and "dispatch" (scheduling generation units), so a UTC, like a physical transaction, affects pricing and dispatch.

[5] The Commission explained in the Penalty Order that "Convergence in the PJM market is the reduction in the spread between day-ahead and real-time LMPs at a specific node." Penalty Order at P 17 n.26.

Penalty Order at PP 20 and 17 (describing how virtual trading has a "direct role in day-ahead price formation").

45. Even though virtual products like UTCs are not physically delivered, they help to set the prices for physically-delivered electricity. With virtual transactions, such as UTCs, a purchase (or sale) at the day-ahead price is automatically sold (or purchased) at the real-time price. Simplifying somewhat, if a trader made a 10 MW purchase at the day-ahead price of $20/MW, those 10 MW would financially settle at the real-time price, which may be higher or lower than $20 (with that difference, less transaction costs, being the gain or loss on the trade) without the need for the trader to actually make an offsetting sale.

46. A UTC transaction works much like the generic virtual transaction just described, but the settlement is based on locational price differentials, rather than the prices at a single location. That locational price differential is the "congestion" from which the "Up-To Congestion" product takes its name. When entering into a UTC transaction, the trader specifies two locations (nodes), a market hour, and that she will pay "up to" a specified dollar amount (capped at $50) in the day-ahead market to receive the price differential between the two locations (nodes) in the real-time market. If the day-ahead market price differential calculated by PJM's pricing model is at or below the price specified by the person placing the transaction, the transaction will clear.

47. UTCs were designed to allow market participants to hedge the risks associated with their real-time trades, but have evolved into a financial product used to arbitrage price differences between points. *See* Penalty Order at PP 18-20.

48. During and prior to the Manipulation Period, placing a UTC trade was a two-step process: as the first step, the trader would use PJM's Open Access Same Time Information System (OASIS) to reserve some amount of transmission for the intended transaction.[6] If transmission capacity was available, the trader would receive an OASIS reservation number, which enabled the trader, as the second step, to enter the transaction specifics – time of day, source and sink nodes (i.e., the pricing points),[7] volume (i.e., the amount of MW), and the "up-to" price limit he was willing to pay – into a different PJM system. After the time period for entering transactions closed, PJM would establish the day-ahead prices at the nodes. For a trader's bid to be accepted (i.e., to "clear"), his bid had to equal or exceed the day-ahead price spread on the trader's specified path (i.e., the difference in day-ahead price between the source and sink nodes).

49. If the bid cleared, then the profitability of the transaction (exclusive of transaction costs) would be determined by whether the price spread in the real-time market on the chosen path was higher or lower than it had been in the day-ahead market, that is, whether the trader had accurately predicted any change in congestion between the day-ahead and real-time. Thus, in principle, both the market and traders can benefit from UTC trades: traders by profiting from spreads between day-ahead and real-time prices, and the market by the more efficient pricing and dispatch that convergence of day-ahead and real-time prices brings.

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[6] Transmission is how electricity gets from one place to another.

[7] A "source" is the point of injection of energy; a "sink" is the point of withdrawal. Energy flows from the "source" to the "sink." UTCs combine an offer to sell at the source LMP with a bid to buy at the sink LMP in the day-ahead market.

B. Marginal Loss Surplus and Its Allocation.

50. As discussed above, one of the components of LMP is the cost of the megawatts of electricity that are lost as the energy is transmitted across the grid. This is called "line loss." As the Commission has observed, the more demand there is on the grid, the greater the number of megawatts will be lost in transmission. Penalty Order at P 23 (citing *Atlantic City Elec. Co., et al. v. PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,132, at PP 3, 5 (2006)). To ensure that customers pay the true cost of transmitting electricity to their particular location, the Commission required that the "line loss" component of the LMP reflect the marginal cost (i.e., the most expensive increment of line loss), rather than the average cost, of such losses. Without this, prices in PJM would be distorted because they would not reflect the true costs of generation. *See Atlantic City Elec.*, 115 FERC ¶ 61,132 at P 4. Remote generation would falsely appear to be cheaper than it is, because it would not account for the additional losses that would occur (and would have to be paid for) if it were called upon. Under average loss pricing, a remote generator that lost 10% of its output on the line and was only about 5% cheaper than a nearby generator that would not lose any of its output on the line would appear to be the lower cost option, even though the costs imposed on the system would be greater. *Id*. P 4 n.2 (providing a detailed example). Marginal loss pricing, by contrast, reflects "the actual cost of meeting load" and thus reduces prices overall. *Id*.

51. In establishing marginal loss pricing, the Commission recognized that "because marginal costs of line losses are greater than average costs, PJM receives more payments [from purchasers of power] than necessary to compensate [generators] for actual line losses [i.e., the additional power they supply to make up for transmission-related losses],

resulting in a surplus revenue." Penalty Order at P 23 (footnotes omitted). This additional revenue is called "marginal loss surplus."

52. The Commission directed PJM to develop a method for disbursing the marginal loss surplus and, in September 2009, approved PJM's proposal to distribute this surplus by a marginal loss surplus allocation (MLSA) that "paid MLSA on a *pro rata* basis to network service users and transmission customers (including virtual traders) in proportion to their ratio shares of the total MWs of energy: (i) delivered to load [i.e., demand] in PJM; (ii) exported from PJM; or (iii) cleared in a UTC transaction that paid for transmission services during such hour." *Id*. P 24 (footnote omitted). In other words, MLSA payments were allocated on an hourly basis to network services users and transmission customers, including UTC traders, in proportion to the volume of MWs of paid-for transmission that they had reserved in connection with their trades.

C. Powhatan's Owners Partner With Chen to Fraudulently Trade and Collect MLSA Payments.

53. Former Defendant Alan Chen, who has a doctoral degree in power engineering and worked for years as an analyst in energy market modeling, first became familiar with the UTC product while working as an analyst at Merrill Lynch. In September 2007, Alan Chen left Merrill Lynch to establish HEEP Fund for the sole purpose of making UTC trades. Penalty Order at P 11.

54. In February 2008, Lawrence S. Eiben contacted Alan Chen to propose that Alan Chen provide portfolio management services to TFS Capital, LLC with regard to TFS

Capital's trading in the UTC market. Staff Report at 6.[8] At that time, Eiben was an employee-owner of TFS Capital. *Id*.

55. TFS Capital and HEEP Fund, through Alan Chen, executed an Advisory Agreement[9] (the First Advisory Agreement) commencing May 1, 2008, pursuant to which Alan Chen agreed to execute, on behalf of TFS Capital, trades identical to the trades he executed on behalf of HEEP Fund, albeit in greater volumes. Penalty Order at P 12 (citing Staff Report). As with Alan Chen's later agreement with Powhatan, TFS Capital compensated Alan Chen based on a percentage of the profits earned by his trades for TFS. Staff Report at 6-7.

56. Eventually, another company, Huntrise Energy Fund, LLC (Huntrise), succeeded TFS Capital's interest in the First Advisory Agreement. Penalty Order at P 12 n.22 (citing Staff Report at 6-7). Huntrise, which has since been shut down, was a private investment fund with its principal place of business in Richmond, Virginia. *Id*. Alan Chen traded UTCs on behalf of TFS Capital until June 2008. From June 3, 2008 through May 5, 2010, Alan Chen traded UTCs on behalf of Huntrise. *Id*.; *see also* Staff Report at 7.

57. The Commission found that during the period of September 2007 to October 2009, Alan Chen traded UTC lawfully, on the basis of "market fundamentals and the models he developed." Penalty Order at PP 38-39 nn.87-88. This trading was

[8] App. A to Order to Show Cause, *Houlian Chen, et al*., 149 FERC ¶ 61,261 (2014), revised, 149 FERC ¶ 61,263 (Staff Report). The Staff Report and Order to Show Cause are attached hereto as Exhibit 2.

[9] Advisory Agreement between HEEP Fund Inc. and TFS Capital LLC (May 1, 2008).

characterized by a "careful, low-risk approach" to taking positions in the market. *Id*. P 39. The Commission called this "the first phase of Dr. Chen's UTC trading." *Id*.

58. During autumn 2009, while he traded for HEEP and Huntrise, Alan Chen discovered that his UTC trades had retroactively been credited with MLSA payments. *Id*. P 41. As he analyzed this new information, Alan Chen discovered that the credits associated with trades executed in certain predictable periods exceeded the costs of executing those trades during those periods. *Id*.

59. This analysis caused Alan Chen, beginning in autumn 2009, to "alter[] his UTC trading strategy away from fundamentals-based spread trading to a strategy designed to capture increased volumes of MLSA payments." *Id*. P 42 (footnote omitted). Thus began what the Commission calls the "second phase" of Alan Chen's UTC trading. *Id*.

60. Alan Chen shared this analysis with Powhatan investor Kevin Gates, who in turn shared it with his partners and advised them to "ramp up" their trading volumes. *Id*. PP 42-43. Alan Chen disclosed to Kevin Gates that, beginning in February 2010, he had "kicked up" his trading volumes "to target" MLSA payments. *Id*. PP 43-44 (quoting Email from Alan Chen to Kevin Gates (Mar. 5, 2010, 9:37 PM)). Alan Chen and Kevin Gates agreed that they wanted to increase their trading volumes in summer 2010 in order to capture a greater share of the larger MLSA payment pool available during the "hot summer." Penalty Order P 43 (quoting Chen Test. Vol. I Tr. 94:10-12 (Oct. 7, 2010)).

61. During this second phase of Alan Chen's UTC trading, Respondents learned that they could incur substantial losses from transaction costs and price spread changes but still generate gains due to MLSA payments. *Id*. P 42. Consequently, Respondents increased their trading volumes and their focus on MLSA payment capture. *Id*. PP 42-46.

62. In early 2010, Alan Chen began implementing a new strategy on behalf of HEEP and Huntrise, which sought to maximize MLSA payment capture while minimizing exposure to market prices. This "correlated pairs" strategy involved identifying closely correlated nodes (i.e., geographically proximate nodes whose prices tended to move in tandem) and placing trades between them and a third node. *Id*. P 42. Thus, an A to B trade was paired volumetrically and in the same hour with a B to C trade. In effect, this created an A to C trade. Because the price spread and volatility between A and C was expected to be de minimis (given that they are close to one another and experience similar pricing), profits from the correlated pairs strategy were derived from the difference between MLSA payments on the one hand and, on the other, transaction costs plus spreads (which, again, were expected to be de minimis) between A and C.

63. In March 2010, Alan Chen explained to Kevin Gates that "[w]ithout [MLSA payments], I would not touch some of the trades and/or would not put in large volumes for some of the trades. But with [MLSA payments] as is, they are suddenly becoming risk-free (almost to the point) trades." *Id*. P 69 n.175 (quoting email from Alan Chen to Kevin Gates (Mar. 5, 2010, 9:37 PM)).

64. In March 2010, Kevin Gates and his fellow investors (the Relief Defendants) created a new fund, Powhatan Energy Fund, LLC. *Id*. P 13. Kevin Gates and his fellow investors created Powhatan "[i]n order to 'ramp up' their participation in this new form of UTC trading and to avoid the potential liability of having to return MLSA payments" in the event PJM attempted to reclaim them. *Id.* P 46 n.108.

65. In spring 2010, HEEP and Powhatan executed the Powhatan Advisory Agreement, which superseded the First Advisory Agreement. *Id*. P 13. Under the terms

of the Powhatan Advisory Agreement, Alan Chen agreed to trade UTCs for Powhatan on the basis of a 20-to-1 multiplier: '"This means that for every megawatt that HEEP trades for HEEP's account, HEEP will place trades for 20 megawatts in [Powhatan's] account."' Staff Report at 8 (quoting Powhatan Advisory Agreement). The multiplier in the First Advisory Agreement was 2.5-to-1.

66. Shortly after Alan Chen began trading for Powhatan, the correlated pairs strategy failed. A price spike unexpectedly affected only one leg of a correlated pair, which caused a sharp and unexpected price divergence (i.e., the A node did not experience a spike, but the C node did, meaning that, contrary to the purpose of the trades, the A to B and B to C price spreads did not offset). Penalty Order at P 47. The net result was that HEEP and Powhatan lost money – in Powhatan's case, a significant amount, due to the multiplier effect – over the course of only a few hours on May 30, 2010. *Id*. P 47.

67. After this unexpected loss, Alan Chen changed his trading strategy again. *Id*. In this "third phase" of trading, the Commission found that

> Dr. Chen developed his round-trip UTC trading strategy between the same two points (A-to-B, B-to-A). Round-trip trading would effectively eliminate any risk of losing (or earning) money based on price spreads because the matched trades' price spreads canceled each other out. Dr. Chen's round-trip UTC strategy canceled [price] spread risk; profits instead came only from collection of MLSA payments, which themselves were now collected in a more effective way than they had been in phase two where some price spread risk was possible if the selected nodes did not move in tandem.

Id. (footnote omitted).

68. In summer 2010, Alan Chen created a second fund, called CU Fund, Inc., for which he traded UTCs. *Id*. P 14. Because CU Fund was not bound by any advisory agreement with Powhatan, "Dr. Chen was able to trade UTCs on behalf of CU Fund and

collect the associated MLSA payments solely for his own economic benefit." *Id*. Chen did not inform Powhatan about the existence of CU Fund. *Id*. P 14; Staff Report at 29.

69. For CU Fund, Alan Chen implemented the same round-trip UTC trading strategy (i.e., trades in opposite directions on the same paths in the same hours, e.g., an A to B trade and a B to A trade both at 3:00pm) that he had implemented for HEEP and Powhatan, often placing round-trip trades on the same paths in the same hours for all three funds. Penalty Order at P 22.

70. Alan Chen placed manipulative round-trip trades on behalf of CU Fund every day from July 17, 2010 through July 31, 2010 (inclusive) and August 3, 2010. He placed such round-trip trades on behalf of HEEP Fund and Powhatan every day from June 1, 2010 through August 3, 2010 (inclusive).

71. Over the course of the Manipulation Period, Alan Chen, on behalf of Powhatan, HEEP Fund, and CU Fund, executed approximately 16.6 million MWh of round-trip UTC trades. This amounted to approximately 10% of all reservations to flow electricity across PJM during that time. *Id.* P 99. These trades resulted in the misdirection of approximately $10.1 million of MLSA payments to Powhatan, HEEP Fund, and CU Fund. *See* Staff Report at 32.

ENFORCEMENT'S INVESTIGATION OF DEFENDANTS

72. In late July 2010, certain market participants informed PJM that they were experiencing unexpected difficulty in reserving transmission. Following these inquiries, PJM discovered that, beginning on June 1, 2010, several market participants (including Respondents) had been reserving large quantities of transmission in OASIS (see ¶ 48 above) associated with high volumes of UTC bids. Penalty Order at P 26. With respect

to Powhatan, HEEP Fund, and CU Fund, PJM discovered (and described in its letter referring the matter to the Office of Enforcement) that they had been submitting high volume UTC transactions '"in opposite directions between the same two points."' *Id*. (quoting PJM Referral), *and see* AR No. 179.[10]

73. The Commission's Office of Enforcement ("Enforcement") started investigating UTC trading by Respondents (and others) after reviewing the information in PJM's Referral and receiving a separate oral referral from PJM's Internal Market Monitor (IMM).[11] On August 18, 2010, Respondents received letters directing them to preserve documents and information relevant to this investigation.[12] *See* AR Nos. 56 and 64. On

[10] For the Court's convenience, reference is made throughout this section to the Administrative Record Plaintiff filed at the Court's request on December 10, 2015. The Court's Memorandum Opinion of December 28, 2017 states that "the entire record before the Court—to which FERC refers as the 'administrative record'—consists of information compiled before the Commission issued the OSC and before Respondents made their penalty assessment election." Memorandum Order, at 4. However, it is not so limited. While the Administrative Record filed in this case does include materials gathered in the investigation, it also includes material submitted to the Commission by Defendants after the Order to Show Cause and while the Commission was considering its merits order. Notably, it contains all of the pleadings submitted by the parties in the underlying administrative hearing. *See* Administrative Record Index, ECF No. 37 (materials submitted after the Order to Show Cause include Defendants' Answer to the Order to Show Cause and numerous exhibits in support thereof).

[11] The IMM subsequently provided a written referral as well. AR No. 214.

[12] Respondents' receipt of this directive mere days after PJM provided its referral – as well as contemporaneously and subsequently-issued data requests and testimony taken from Alan Chen, Kevin Gates, and Lawrence Eiben, among others – put Defendants' on notice that they were under investigation years before the OSC issued. Respondents' awareness of this is reflected in, among other things, the defenses they made of their conduct in written submissions beginning on December 8, 2010 – just four months after receiving the preservation directive and almost exactly four years before the Commission issued its Order to Show Cause on December 18, 2014. *See, e.g.*, AR No. 2 (first written submission of Alan Chen presenting defenses) *and* AR Nos. 44-55 (testimony transcripts); *see also*, 18 C.F.R. § 1b.18 (authorizing "any person" to submit statements, arguments or evidence "at any time" during an investigation).

August 25, 2010, the Commission issued an order of formal investigation. *PJM Up-To Congestion Transactions*, 132 FERC ¶ 61,169 (2010) (AR No. 1).

74. During the investigation, Enforcement obtained and reviewed Respondents' emails, trade records, and responses to interrogatories, along with similar materials from PJM, and other participants in the UTC market. Enforcement analysts reviewed transactional information and Enforcement attorneys took Alan Chen's testimony and the testimony of a number of Powhatan's investors and officers. Enforcement also studied the multiple submissions made by Respondents. AR Nos. 2-5.

75. After reviewing and considering these materials, Enforcement preliminarily concluded that Respondents had committed violations. Consistent with the Commission's established practice, *see Enforcement of Statutes, Regulations, and Orders*, 123 FERC ¶ 61,156, at P 32 (2008), on August 9, 2013, Enforcement provided written notice that it had preliminarily determined that Respondents had violated the Anti-Manipulation rule; explained the evidence on which it relied; and invited Respondents to provide an explanation for their behavior (Preliminary Findings Letters) (AR Nos. 6, 7).

76. Respondents responded on October 8 and 9, 2013, respectively. AR Nos. 8, 9. In their responses, Respondents did not dispute having executed any of the trades described in the Preliminary Findings Letters.

77. In September 2014, Enforcement determined that it would recommend to the Commission that the agency initiate a public proceeding wherein Enforcement could bring its allegations against Respondents. Consistent with the Commission's regulations,

18 C.F.R. § 1b.19 (2017), Enforcement notified Respondents of this forthcoming recommendation and again invited a response. AR Nos. 10, 11.

78. Respondents responded on September 24, 2014. AR Nos. 12, 13 (1b.19 Responses).

79. After considering Respondents' 1b.19 Responses, Enforcement staff prepared and submitted an investigative report (Staff Report) recommending that the Commission initiate a show cause proceeding to determine whether Respondents violated the Anti-Manipulation Rule, require disgorgement of unjust profits with interest, and impose civil penalties. Enforcement transmitted Respondents' 1b.19 Responses to the Commission along with its investigative report.

THE CONTESTED ON-THE-RECORD ORDER TO SHOW CAUSE PROCEEDING AND ORDER ASSESSING PENALTIES

80. On December 17, 2014, the Commission issued an Order to Show Cause and Notice of Proposed Penalty to Defendants, directing Respondents to show cause why the recommended penalties and disgorgement set forth in the Staff Report should not be imposed. *Houlian Chen, Powhatan Energy Fund, LLC, HEEP Fund, LLC, CU Fund, Inc.*, 149 FERC ¶ 61,261 (2014), *revised*, 149 FERC ¶ 61,263 (attached hereto as Ex. 2).

81. The Order to Show Cause provided the statutorily-required notice of proposed penalties under FPA sections 31(d)(1), 16 U.S.C. § 823b(d)(1), and 316A(b), 16 U.S.C. § 825*o*-1. The Order to Show Cause did not make any findings or impose any sanctions. *See*, *e.g.*, *Hunter v. FERC,* 569 F. Supp. 2d 12, 17 (D.D.C. 2008) (a FERC order to show cause imposes "practical consequences of answering and participating in an enforcement proceeding," but does not "impose an obligation, deny a right, or fix some legal relationship.") (alterations, quotations omitted); *Indiana & Mich. Elec. Co*., 33 F.P.C.

739, 760 n.18 (1965) ("statements of fact or conclusions of law contained in Orders to Show Cause . . . are tentative, i.e., subject to proof as issues in the proceeding.").

82. Under the Commission's Regulations, issuance of the Order to Show Cause commenced a "contested on-the-record proceeding," subject to the Commission's Rules of Practice and Procedure, 18 C.F.R. Part 385 (2017). *See* 18 C.F.R. §§ 385.209(a)(2) (authorizing the Commission to initiate a proceeding by issuing an order to show cause) and 385.2201(c)(1)(i) (defining "any proceeding initiated by the Commission on its own motion . . . or any proceeding arising from an investigation under part 1b of this chapter beginning from the time the Commission initiates a proceeding governed by part 385 of this chapter" as a "contested on-the-record proceeding").

83. The Show Cause proceeding was subject to the Commission's *ex parte* rule, 18 C.F.R. § 385.2201 (2017) (prohibiting any off-the-record communications about a contested on-the-record proceeding) and Separation of Functions Rule, 18 C.F.R. § 385.2202 (2017) (providing that "no officer, employee, or agent assigned to work upon the proceeding or to assist in the trial thereof, in that or any factually related proceeding, shall participate or advice as to the findings, conclusions or decision, except as a witness or counsel in public proceedings."). *See* AR No. 14, ECF No. 37 (Notice of Designation of Commission Staff as Non-Decisional). Enforcement staff who had been involved in the investigation were thus prohibited from advising or communicating with the Commission during its deliberations with respect to findings, conclusions, or decisions, except through on-the-record filings.

84. With this Separation of Functions Rule in place, the four independent Commissioners listed on the cover page of the Penalty Order comprised a quorum of the

Commission, and voted independently in favor of the Order. Penalty Order at 1; *see* 16 U.S.C. § 792 (2016) (establishing FERC as a five-member independent Commission, with a quorum of three). The Commission's then-Chairman did not participate in the matter. Penalty Order at Ordering P (H).

85. Enforcement staff filed investigative materials confidentially with the Commission on January 2, 2015, which it supplemented on March 3, 2015, to correct certain inadvertent omissions. AR Nos. 20, 35. Both filings were served on Respondents contemporaneously.

86. On January 12, 2015, Respondents notified the Commission of their decision under section 31 of the FPA to waive their opportunity for a trial-type proceeding before an administrative law judge pursuant to 5 U.S.C. § 554 (2016) in favor of a hearing before the Commission, with the potential for review *de novo* by a federal district court of any penalty assessment. Penalty Order at P 33; *see* AR No. 21.

87. Respondents answered the Order to Show Cause on February 2, 2015. Penalty Order at P 33; *see* AR Nos. 28, 29. On February 9, 2015, Alan Chen, HEEP, and CU Fund filed a Supplemental Answer. AR No. 31. Respondents' answers presented evidence and argument directly to the Commission, including evidence not gathered during the investigation. *See*, *e.g.*, AR No. 29, Ex. A (Affidavit of Houlian Chen).

88. Enforcement Staff replied to the answers on March 3, 2015. AR Nos. 33, 34.

89. The Commission reviewed the briefs and the extensive administrative record – encompassing materials compiled during the investigation, materials submitted by Respondents during the contested on-the-record show cause proceeding, and the pleadings of the Respondents and Enforcement and, on May 29, 2015, unanimously

issued the Penalty Order. In the Penalty Order, the Commission found, "[b]ased on the totality of the record in this proceeding, . . . that Respondents' round-trip UTC trading during the Manipulation Period [i.e., June 1, 2010 to August 3, 2010] violated section 222 of the FPA and the Anti-Manipulation Rule." Penalty Order at P 4. The Penalty Order, attached as Exhibit 1, is expressly adopted and incorporated by reference in this Second Amended Complaint.

CLAIM DEFENDANT'S VIOLATIONS

90. Section 222 of the FPA, 16 U.S.C. § 824v, prohibits manipulation in connection with the electricity and transmission markets subject to Commission jurisdiction. The Commission's Anti-Manipulation Rule, 18 C.F.R. § 1c.2, adopted by the Commission through notice-and-comment rulemaking pursuant to the express rulemaking authority granted to it by the FPA, likewise prohibits manipulation in such markets. For the reasons set forth in the Penalty Order and described below Defendant Powhatan violated both of these prohibitions by knowingly engaging in a practice that operated as a fraudulent device, scheme, or artifice involving Commission-jurisdictional transactions.

91. Powhatan's scheme, executed through Alan Chen, involved executing offsetting volumes of UTC trades in opposite directions between the same pricing points (i.e., A to B and B to A) in the same hours for the purpose of capturing MLSA payments.

A. Respondents **Engaged in a Manipulative Scheme.**

92. Respondents' conduct was fraudulent and manipulative because it was deceptive and because it impaired, obstructed, or defeated a well-functioning market.

93. Respondents' "round-trip UTC transactions were deceptive and manipulative" because the trades were entered separately and thus appeared to be independent, rather

than deliberately offsetting. As the Commission described it, the trading activity involved "plac[ing] separate bids for each leg of their round-trip UTC transactions in the PJM market, just as other market participants would place routine arbitrage-based UTC trades. As a result, the two separate legs of Respondents' offsetting trades were not connected and falsely appeared to PJM as legitimate UTC trades, thus concealing their fraudulent nature and purpose." Penalty Order at P 5.

94. Respondents' round-trip trades were fraudulent and manipulative because they impaired, obstructed, or defeated a well-functioning market inasmuch as they intentionally distorted the allocation of payments provided for by the tariff. In making this finding, the Commission noted that "the term 'well-functioning market' is not limited just to consideration of price or economically efficient outcomes in a market." *Id*. P 49. Rather, the Commission "view[s] the term to also broadly include consideration of 'such rules and regulations as the Commission may prescribe as necessary or appropriate,' which necessarily includes the rates, terms, and conditions of service in a market. Here, we find that intentionally subverting the allocation of payment provided by a tariff approved by the Commission constitutes interference with a 'well-functioning market.'" *Id*. (citing 16 U.S.C. § 824v).

95. Respondents' round-trip UTC trades were wash trades. As the Commission explained, "Respondents' round-trip UTC trades were designed to ensure that both legs of a transaction would cancel each other out, thereby eliminating any associated price risk. As the Commission has previously articulated, trades that are pre-arranged to cancel each other out and involve no economic risk are wash trades, which are inherently

fraudulent." Penalty Order P 6 (citing *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218, at P 53 (2003)).

B. Respondents Acted Knowingly and Intentionally.

96. Respondents implemented their manipulative wash trading scheme knowingly and intentionally. The Commission found that "the evidence shows that Respondents, individually and together, knowingly and intentionally participated in a manipulative scheme to engage in wash trading and deceive PJM about the true nature of their transactions, thereby harming the market and other market participants." Penalty Order P 128.

97. Alan Chen, HEEP, and CU Fund acted with scienter. The Commission based its finding of scienter "principally on: (1) evidence that Dr. Chen understood that his fraudulent trading scheme was inconsistent with, and obstructed the market design purpose of, UTC trading in PJM; (2) evidence of the pattern and evolution of Dr. Chen's round-trip UTC trading; and (3) Dr. Chen's deliberate decision to increase profits for himself after perfecting his scheme." *Id*. PP 129-136.

98. Respondents' alternative explanation of their purposes, the so-called "home run" strategy, is disproven by the contemporaneous evidence. The supposed "home run" strategy was an explanation for Respondents' trading proffered during the investigation and show cause proceeding which posited that the round-trip trades had not been placed for the purpose of capturing MLSA payments, but rather for the purpose of capitalizing on unforeseeable and unlikely "black swan" type events. *Id*. P 52 n.124; Staff Report at 42 n.232. The home run theory suggested that Respondents desired for one leg of a round-trip pair to be rejected in the hopes that the resulting market exposure would result

in windfall profits (rather than significant losses). The Commission rejected this explanation and found that Respondents' "creation of a *post hoc* explanation – the home run strategy – for which there is no evidentiary support contemporaneous with the relevant trading conduct" provided further support for the Commission's finding that they acted with scienter. Penalty Order at P 129; *see also* PP 86-93 (footnote omitted).

99. Powhatan acted with scienter. The contemporaneous evidence demonstrates that it knew of Alan Chen's round-trip trading scheme; understood the implications of that scheme; knowingly supported the implementation of that scheme; and deliberately sought to maximize the profits it derived from that scheme. *Id.* PP 137-40.

100. Respondents understood exactly what they were doing. The Commission found that Respondents' "communications and testimony show that Respondents understood that their round-trip UTC trades had little price risk by design, were not undertaken to arbitrage price spreads, were certain themselves to lose money, and were placed only to create the illusion of volume trading to obtain transmission and thereby earn MLSA payments that otherwise would have gone to other market participants." *Id*. P 72.

C. Respondents' Manipulative Scheme Caused Harm.

101. Respondents' manipulative scheme harmed other market participants. For one thing, the scheme involved the misallocation of credits to Respondents and away from market participants who, having executed bona fide transactions, were legitimately entitled to receive them. *Id*. P 98 ("identifiable market participants were harmed by Respondents' conduct; they did not receive the MLSA payments they would have received absent Respondents' unlawful round-trip UTC trades, as provided for under the then-effective PJM Tariff's MLSA provision.")

102. In addition, Respondents' hoarding of transmission in order to execute their manipulative trades also harmed market participants because it meant that the transmission was not available (or was greatly reduced) when those other market participants sought to use it for their own non-manipulative transactions. The Commission found that "[d]uring the Manipulation Period, Respondents scheduled more than 16.6 million MWh of transmission service in connection with their fraudulent, round-trip UTC trades, which amounted to more than 10 percent of all day-ahead transmission service reservations in PJM." *Id*. P 99 (footnotes omitted). This "impacted the availability of transmission from the time they reserved this transmission service until the time it was released for other market participants' use in the real-time market." *Id*.

D. Respondents' Manipulative Scheme Involved Jurisdictional Transactions.

103. The Commission has jurisdiction over Respondents' UTC trading. *Id*. PP 144-148. UTCs are "integral to the operation and settlement of Commission-jurisdictional wholesale markets," and "can affect the outcomes of the settlement of the day ahead physical market." *Id*. P 146 (footnotes and citation omitted).

104. Respondents' UTC transactions involved reservation of transmission. "[T]he Commission's jurisdiction over transmission is extremely broad." *Id*. P 147 (citing *New York v. FERC*, 353 U.S. 1, 16-17 (2002)).

105. The Commission has jurisdiction over conduct "in connection with jurisdictional trades" under FPA section 222, 16 U.S.C. §824v(a). Respondents' trades were sufficiently "in connection" with jurisdictional transactions to satisfy the jurisdictional nexus under that provision as well. Penalty Order at P 148.

106. Finally, Respondents' UTC trades and the transmission reservations and marginal loss surplus allocation payments associated with them were all implemented pursuant to a Commission-approved tariff by PJM, a Commission-regulated RTO. *Id*. P 145. The Commission must ensure that the terms and conditions embodied in filed tariff provisions that are in connection with jurisdictional transactions are just and reasonable. *Id*. P 144 n.344 (citing 16 U.S.C. §§ 824d(a) and 824e(a) (2012)).

E. The Commission Determined Appropriate Civil Penalties.

107. Having concluded that Respondents manipulated the wholesale electric market in PJM, the Commission assessed penalties of $16,800,000 for Powhatan; $10,080,000 for CU Fund; $1,920,000 for HEEP Fund; and $1,000,000 for Alan Chen.

108. The Commission found these penalties to be statutorily authorized under the FPA and appropriate in this case. Penalty Order at PP 149-87. The Commission determined that the penalties were well below the statutory maximum authorized in this case. *Id*. P 150.

109. In determining the appropriate civil penalties for the corporate Respondents (Powhatan, HEEP, and CU Fund), the Commission applied statutory factors and its own Penalty Guidelines.

110. The statutory factors require the Commission to consider '"the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner."' *Id*. P 151 (quoting FPA Section 316A(b), 16 U.S.C. § 825o-1(b)). The Commission determined that the violations were serious, and that there was no attempt to remedy the violations in a timely manner. *Id*. PP 186-187 n.408.

111. The Commission explicitly applied its non-binding Penalty Guidelines and, in so doing, explained in detail its reasons for concluding that the penalties were reasonable.

112. The Commission found that it was appropriate to hold Powhatan and HEEP jointly and severally liable for the $1,920,000 penalty assessed against HEEP. *Id*. P 164. The Commission found that "[w]ere we not to adopt joint and several liability, entities engaged in the intentional act of fraud could potentially avoid paying the full penalty and disgorgement amounts. This would be improper." *Id*. P 165 (citing Email from Kevin Gates to Richard Gates (Mar. 21, 2010, 7:55 AM) (noting that if PJM sought to claw back MLSA payments "we'd bankrupt our company and not pay PJM")).

113. The Commission similarly found that it was appropriate to hold Powhatan and HEEP jointly and severally liable for the $16,800,000 penalty assessed against Powhatan "given the collusion between them." *Id*. P 175 (footnote omitted).

POWHATAN'S TRANSFERS OF UNLAWFUL PROFITS TO RELIEF DEFENDANTS

114. In or about 2010, shortly after learning of Enforcement's investigation of Powhatan's trading, Powhatan distributed $4,000,300.00, more or less, to its investors, the Relief Defendants. These distributions took place on two occasions: in or about August 2010, and in or about October 2010. The distributions were conditioned on, among other things, each Relief Defendant's written promise to return the funds to Powhatan if deemed necessary by Powhatan's managing member, LSE Capital Management, and to maintain the funds unspent in liquid investments. The Commission learned of the conditional nature of the distributions to the Relief Defendants, and their promise to repay the funds on demand by LSE, only as a result of discovery in this civil action.

115. Powhatan kept records of the amount of illicit profits earned during the Manipulation Period, as well as each Relief Defendant's "share" of those profits.

116. The amounts distributed to each Relief Defendant in these two distributions are as follows:

A. Relief Defendant Kevin J. Gates received distributions totaling $1,149,285.13, of which, according to Powhatan's own accounting, up to $1,047,340.33 represents proceeds of Powhatan's illegal trading.

B. Relief Defendant Richard J. Gates received distributions totaling $1,146,651.07, of which, according to Powhatan's own accounting, up to $1,006,652.33 represents proceeds of Powhatan's illegal trading.

C. Relief Defendant Lawrence S. Eiben received distributions totaling $1,154,351.80, of which, according to Powhatan's own accounting, up to $1,036,15.61 represents proceeds of Powhatan's illegal trading.

D. Relief Defendant Chao Chen received distributions totaling $385,190.71, of which, according to Powhatan's own accounting, up to $248,446.86 represents proceeds of Powhatan's illegal trading.

E. Relief Defendant Eric S. Newman received distributions totaling $84,049.86, of which, according to Powhatan's own accounting, up to $56,261.57 represents proceeds of Powhatan's illegal trading.

F. Relief Defendant Thomas Michael "Mike" Frederick received distributions totaling $40,272.85, of which, according to Powhatan's own accounting, up to $19,047.70 represents proceeds of Powhatan's illegal trading.

G. Relief Defendant Samuel C. Harris received distributions totaling $22,138.43, all of which, according to Powhatan's own accounting, may represent proceeds of Powhatan's illegal trading.

H. Relief Defendant Gregory M. Sekelsky received distributions totaling $18,360.15, all of which, according to Powhatan's own accounting, may represent proceeds of Powhatan's illegal trading.

117. The amounts received by Relief Defendants constituting Powhatan's unjust profits are subject to disgorgement, as they are ill-gotten funds over which the Relief Defendants have no legitimate claim.

CLAIM FOR RELIEF

118. The Commission repeats each and every allegation set forth in Paragraphs 1 through 118, inclusive, as if set forth fully herein.

119. Powhatan used or employed a fraudulent device, scheme, or artifice, or engaged in an act, practice, or course of business that operates or would operate as a fraud or deceit, with scienter, in connection with electric energy subject to the jurisdiction of the Commission in contravention of FPA section 222, 16 U.S.C. § 824v, and the Commission's Anti-Manipulation Rule, 18 C.F.R. § 1c.2, promulgated to implement that section of the FPA. Powhatan's manipulative scheme involved multiple trades on each of 64 days for HEEP, Powhatan, and Chen. Penalty Order at P 150. Each of these separate days, and each manipulative trade during such days, constitutes a separate violation of FPA section 222, 16 U.S.C. § 824v, and the Commission's Anti-Manipulation Rule, 18 C.F.R. § 1c.2.

120. Accordingly, the Commission seeks an order from this Court affirming and enforcing its assessment of civil penalties against Defendant Powhatan under FPA section 31, 18 U.S.C. § 823b(d)(3)(B), and ordering Powhatan to disgorge its unjust profits.

121. The Commission also seeks an order modifying the award of disgorgement as to Defendant Powhatan. Specifically, to the extent Powhatan's assets are insufficient to satisfy the disgorgement ordered by the Court, the Commission requests that the Relief Defendants be ordered to disgorge the unjust profits actually received by them, plus interest, over which they have no legitimate claim.

JURY DEMAND

122. Plaintiff respectfully submits that this Court can and should affirm and enforce the Commission's penalty assessments as to Powhatan, with the modifications requested herein.

123. Should the Court determine that this matter requires a trial on any issues, the Commission, pursuant to Rule 38 of the Federal Rules of Civil Procedure, demands a trial by jury on all issues triable as such.

RELIEF REQUESTED

WHEREFORE, the Commission respectfully requests that this Court:

(A) Enter an order and judgment affirming the Commission's assessment of a $16,800,000 civil penalty, plus interest, against Powhatan and ordering Powhatan to pay that penalty;

(B) Enter an order and judgment requiring Powhatan to disgorge $3,465,108 in unjust profits, plus interest, it obtained as a result of its illegal manipulative scheme;

(C) Enter orders and judgments requiring the Relief Defendants to disgorge any of Powhatan's unjust profits, plus interest, actually received by Relief Defendants, over which Relief Defendants have no legitimate claim.

(D) Grant such other and further relief as the Court may deem just and proper; and

(E) Retain jurisdiction over this action to enforce any Orders or Final Judgments issued by this Court.

Respectfully submitted,

____

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

FEDERAL ENERGY REGULATORY COMMISSION.	)
Plaintiff,	)
v.	) Civil Action No. 3:15-cv-00452 (MHL)
POWHATAN ENERGY FUND LLC, *et al.*,	)
Defendants.	)

[PROPOSED] ORDER GRANTING LEAVE TO AMEND COMPLAINT

Before the Court is Plaintiff Federal Energy Regulatory Commission's Motion for Leave to Amend Complaint to Add Relief Defendants, under Fed. R. Civ. P. 15(a)(2). The proposed amendment sought by Plaintiff is in the interest of justice, and for good cause shown the motion is granted.

SO ORDERED, this the _____ day of ____________________, 2021.

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