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

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

MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS OF DEFENDANTS HOULIAN CHEN, HEEP FUND, INC. AND CU FUND, INC.

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INTRODUCTION

The complaint here should be dismissed for four reasons—two covering the entire case and two covering part of the case.

First, the Federal Energy Regulatory Commission ("FERC") filed this action too late. Under 28 U.S.C. § 2462, FERC had five years from the conduct at issue to file its complaint. Since the beginning days of the Republic, our legal system has required the government to bring civil penalty actions five years from the disputed conduct. *Gabelli v. SEC*, 133 S. Ct. 1216, 1220 (2013). Quoting Chief Justice Marshall, the court in *Gabelli* held "it 'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'" *Id*. (quoting *Adams v. Woods*, 2 Cranch 336, 342, 2 L.Ed. 297 (1805)).

FERC fails this centuries-old test. It challenges trading that occurred from June 1, 2010 to August 3, 2010, meaning it needed to file this action by June 1, 2015 to capture all of the trading at issue. But it did not file until July 31, 2015. Therefore, all but the last four days of trading are time-barred. And that bar applies not only to FERC's claim for civil penalties, but also to its claim for disgorgement. Where the statute of limitations bars a legal claim, it also bars concurrent equitable remedies like disgorgement.

Second, FERC fails to state a claim that the defendants engaged in market manipulation in violation of Federal Power Act ("FPA") § 222, 16 U.S.C. § 824v, which expressly requires FERC to establish a "manipulative or deceptive device or contrivance," as those terms are used in § 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j. FERC's allegations of fraud-based market manipulation suffer fatal legal flaws, and also fail to plead fraud with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure.

FERC cannot state a claim for fraud by alleging the defendants made trades that "falsely appeared" to be "legitimate," thus "concealing their fraudulent nature and purpose." Compl.

¶ 81. Legal conclusions and circular reasoning like this do not meet the basic pleading requirements imposed by the Supreme Court and Rule 9(b). These allegations also fail as a matter of law because FERC does not, and cannot, point to any rule or agency pronouncement, prior to the trading at issue, that made the trading at issue somehow "illegitimate," or required the defendants to make any representation at all about the nature or purpose of the trades. And it is legally impossible for the defendants to have "falsely appeared" to comply with a requirement that never existed to begin with.

FERC's claim also fails as a matter of law because FERC seeks to evade the requirement of pleading (and proving) fraud. Specifically, FERC purports to establish that the trades at issue were "fraudulent and manipulative because they impaired, obstructed or defeated a well-functioning market." But that purported standard has no foundation in the FPA or in decades of jurisprudence under Securities Act § 10(b). Instead, it is based on FERC's misreading of *Dennis v. United States*, 384 U.S. 855, 861 (1966), where fraud was a given.

In addition, FERC alleges the disputed trades were wash trades. But FERC's prior ban against wash trades required offsetting trades with no economic risk and no exchange of beneficial ownership. As pled in the complaint, the trades here fail that test. They had economic risk because they made approximately $4.7 million. And they exchanged beneficial ownership because they exchanged (1) fixed transaction charges for (2) floating levels of one type of revenue. These are, as pled, real transactions with real economic substance, not wash trades.

Third, because FERC's failed effort to allege fraud rests on agency pronouncements that came *after*, *not before*, the trading at issue, FERC's case violates the constitutional requirement of clear prior notice. As the Fourth Circuit has emphasized, that doctrine has particular strength in the quasi-criminal context of civil penalties. FERC cannot accuse the defendants of violating rules it has made up after the fact. And that is exactly what it seeks to do here.

Fourth, FERC lacks statutory authority to claim that defendant Dr. Houlian Chen engaged in market manipulation. FERC is statutorily authorized to pursue such claims only against entities, not against persons. And Dr. Chen is not an entity. He is a person.

BACKGROUND

I. FACTUAL BACKGROUND

During the time frame relevant here, an organization called PJM Interconnection, L.L.C. ("PJM"), operated various markets involving electricity. Compl. ¶¶ 4, 33-39. Due to technical details of some of those markets, PJM collected a surplus of dollars—termed "marginal losses"—that it then redistributed to market participants. *Id.* ¶¶ 44-45. With FERC's approval, PJM redistributed that surplus on a pro rata basis to anyone who paid PJM for transmission service, reasoning that those payments helped defray the costs of the transmission system. *Id.*

In 2010, Dr. Houlian Chen was trading in a particular PJM market called the "up-to congestion" (or "UTC") market, on behalf of himself, his two funds (HEEP Fund and CU Fund), and co-defendant Powhatan Energy Fund, LLC. *Id.* ¶¶ 39, 47-49. Up-to congestion trades have several components of profit and loss. From June to August 2010, an up-to congestion trade required payment of fixed transmission charges (and other minor transaction costs). *Id*. Ex. 1 at P 2 & n.37.[1] Having paid those transmission charges, the traders received allocations of loss credits—precisely as FERC ordered. *Id.* Ex. 1 at PP 22-25. Up-to congestion trades also involved exposure to what FERC calls "price risk" or "price spreads," *id.* PP 18, 47, which could create either profit or loss, Compl. ¶ 70 & Ex. 1 at P 18. In some circumstances, however, a trader might have other positions offsetting the price risk in an up-to congestion trade, either

[1] When ruling on a motion to dismiss, the court "may [] consider documents attached to the complaint, *see* Fed. R. Civ. P. 10(c), as well as those attached to the motion to dismiss, so long as they are integral to the complaint and authentic." *Philips v. Pitt Cnty. Mem'l Hosp.*, 572 F.3d 176, 180 (4th Cir. 2009).

reducing or eliminating that exposure on an all-in basis. Compl. Ex. 1 at PP 18-19. In fact, the original reason FERC approved PJM's creation of up-to congestion trading was to allow firms to hedge or offset that very same sort of price risk. *Id.*

Commencing in early June 2010, and ending on August 3, 2010, Dr. Chen began placing what FERC has called "offsetting" up-to congestion trades: one trade would be between locations "A" and "B," while another contemporaneous trade would be between locations "B" and "A." Compl. ¶¶ 2, 75 & Ex. 1 at PP 3, 47. If both of these trades were accepted by PJM, then what FERC calls the "price spread" component of both trades would offset. Compl. ¶¶ 39, 75. Profit and loss then would be driven by whether the amount of loss credits—which varied each day—was greater or less than the fixed level of transmission charges (and other minor transaction costs). *Id.* Ex. 1 at PP 18, 47, 64. The disputed trades ultimately made over $4.7 million all in, because loss credits were greater than transactions costs. Compl. (E)-(G).

In July 2010, PJM began examining certain up-to congestion trading, including trading by the defendants that ended on August 3, 2010. *Id.* ¶ 47. Shortly thereafter, PJM amended its rules to end the requirement that up-to congestion trades pay for transmission service and, with that change, ended the payment of loss credits for those transactions. *PJM Interconnection, L.L.C.*, 132 FERC ¶ 61,244 (2010).

II. PROCEDURAL BACKGROUND

On August 25, 2010, FERC began a formal investigation of up-to congestion trading, including by the defendants. Compl. ¶ 48. On December 17, 2014, more than four years later, FERC issued to the defendants an "Order to Show Cause and Notice of Proposed Penalty." *Id.* ¶ 56 & Ex. 2. FPA § 31(d) required FERC to provide the defendants this "notice of the proposed penalty," and also notice that the party facing the proposed penalty has the right to elect one of two mutually exclusive procedural paths for the assessment process. 16 U.S.C. § 823b(d)(1).

FERC must "inform such person of his opportunity to elect in writing . . . to have the procedures of paragraph (3) (in lieu of those of paragraph (2)) apply with respect to such assessment." *Id.* The "paragraph 2" procedures provide for an administrative process, including a hearing before an administrative law judge, *id*. § 823b(d)(2), and the "procedures of paragraph (3)" provide for an "action" in federal district court, *id*. § 823b(d)(3)(B).

If a party elects the administrative path, FERC is authorized to assess a penalty only after making a "determination of violation . . . on the record after an opportunity for an agency hearing pursuant to section 554 of title 5, United States Code, before an administrative law judge." *Id.* § 823b(d)(2)(A). By expressly incorporating § 554 of the Administrative Procedures Act ("APA"), Congress dictated that the "hearing and decision" be "in accordance with sections 556 and 557." 5 U.S.C. § 554(c)(2).

Among other things, that means a FERC order under the administrative path must be based upon a "record" and a party "is entitled" to a hearing before an administrative law judge "to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts." *Id.* § 556(d). The APA also provides that "[t]he transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, constitutes the exclusive record for decision in accordance with section 557 of this title." *Id.* § 556(e). If FERC finds a violation and assesses a penalty based on the record created before the administrative law judge, the party facing the penalty has the right to seek rehearing of FERC's order. 16 U.S.C. § 825*l*(a). If rehearing is unsuccessful, the party can seek judicial review of FERC's final order in a federal court of appeals. *Id*. § 825*l*(b).

In sharp contrast to the administrative path, if a person elects the court path, the statute does not authorize FERC to adjudicate or determine anything; nor does it provide for a "record"

for judicial review. Instead, the statute directs FERC to "promptly assess such penalty, by order," after receiving notice of the party's district court election. *Id.* § 823b(d)(3)(A).

When a party elects the court path, the assessment order "merely triggers the process leading to a de novo trial." *Procedures for the Assessment of Civil Penalties Under Section 31 of the Fed. Power Act*, Order No. 502, FERC Stats. & Regs.¶ 30,828 at 32,038 (1988). Unlike all other FERC orders—including a penalty assessment order under the administrative option—a preliminary assessment order under FPA § 31(d)(3) is *not* subject to agency rehearing. Compl. Ex. 1 at P 193 (citing cases). And because agency rehearing is a statutory prerequisite to judicial review, 16 U.S.C. § 825*l*(b), the subject of this type of order cannot seek judicial review.

Instead, if the subject does not pay, FERC "shall institute an action" in federal district court "for an order affirming the assessment." *Id.* § 823b(d)(3)(B). There the 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 assessment." *Id.*

Here, when it gave notice of proposed penalty, FERC also directed the defendants to file an answer "show[ing] cause" why the disputed trading did not violate FPA § 222 and the corresponding FERC regulation (18 C.F.R. § lc.2), and why penalties should not be assessed. Compl. ¶ 7 & Ex. 2. FERC attached an "Enforcement Staff Report and Recommendation" setting forth enforcement staff's allegations against the defendants. *Id.* As FERC has acknowledged, however, the FPA's detailed penalty assessment procedures do not provide for a "show cause order" process. *See Process for Assessing Civil Penalties; Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317 at P II.5.1 (2006).

The defendants elected the court path set forth in FPA § 31(d)(3). Compl. ¶ 58. Shortly thereafter, they submitted an answer (and other filings) to FERC denying allegations that they engaged in market manipulation and urging FERC to close the matter. *Id.* ¶ 59 & Ex. 1 at P 33.

Although the FPA commands that FERC "shall promptly assess" any proposed penalty when a party elects the district court path, 16 U.S.C. § 823b(d)(3)(A), FERC took no action for more than four months after the defendants filed their election notices. Finally, on May 29, 2015, FERC issued an "assessment order" concluding that the defendants (and co-defendant Powhatan Energy Fund, LLC) violated the FPA, and assessing $29.8 million in civil penalties, along with $4.7 million in disgorgement. Compl. ¶ 60 & Ex. 1. This action followed.

ARGUMENT

I. THE STATUTE OF LIMITATIONS BARS FERC'S CLAIMS FOR ALL BUT THE LAST FOUR DAYS OF THE ALLEGED MANIPULATION PERIOD

A. FERC Must Initiate a Civil Penalty Action Within Five Years of an Alleged Violation

FERC's claim for civil penalties is subject to the "default" five-year statute of limitations, 28 U.S.C. § 2462, that applies in civil penalty actions where, as here, the statute alleged to have been violated does not include a limitations period. *See Prohibition of Energy Mkt. Manipulation*, Order No. 670, FERC Stats & Regs. ¶ 31,202 at P 62 (2006). Section 2462 provides, in relevant part, that "an action, suit or proceeding for the enforcement of any civil fine, penalty, of forfeiture, . . . shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ." 28 U.S.C. § 2462. The date when "the claim first accrued" is the time of the alleged violation. *Gabelli*, 133 S. Ct. at 1220.[2]

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[2] *Accord, e.g.*, *Nat'l Parks and Conservation Ass'n v. Tenn. Valley Auth.*, 502 F.3d 1316, 1322 (11th Cir. 2007) ("A claim first accrues on the date that a violation first occurs."); *3M Co. v. Browner*, 17 F.3d 1453, 1462 (D.C. Cir. 1994) ("[W]e hold that an action, suit or proceeding to *(cont'd)*

1. All But Four Days of the Alleged Manipulation Period Are Time-Barred

FERC alleges the defendants engaged in trades that violated the FPA between June 1 and August 3, 2010—the alleged "Manipulation Period." Compl. ¶ 1. To timely capture all of the disputed trading during that period, FERC needed to file this action no later than June 1, 2015. Instead, FERC filed it on July 31, 2015—more than five years after all but the last four days of the alleged Manipulation Period. FERC's claims for the period prior to July 31, 2010 therefore are barred by § 2462 and should be dismissed.[3]

This outcome follows not only from the statute's plain language, but also from the Supreme Court's 2013 decision in *Gabelli*. There the issue was whether the government could delay the accrual of a fraud claim based on application of the "discovery rule." A unanimous Supreme Court confirmed that the "five-year clock begins to tick" when a defendant's allegedly fraudulent conduct occurs, and the government may not delay accrual until it discovers the alleged fraud. 133 S. Ct. at 1220-24.

The Court emphasized the importance of time limits on civil penalty actions, quoting Chief Justice Marshall's conclusion that "it 'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'" *Id.* (quoting *Adams* 2 Cranch at 342); *see also id.* at 1221 (statutes of limitations are "'vital to the welfare of society'" and "'even wrongdoers are entitled to assume that their sins may be forgotten'") (quoting, respectively, *Wood v. Carpenter*, 101 U.S. 135, 139 (1879), and *Wilson v. Garcia*, 471 U.S. 261,

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assess or impose a civil penalty must be commenced within five years of the date of the violation giving rise to the penalty."); *United States v. Meyer*, 808 F.2d 912, 914 (1st Cir. 1987) (assuming the uncontested point that the action aimed at imposing a civil penalty "must be brought within five years of the alleged violation").

[3] A statute of limitations bar is an affirmative defense that may be raised in a Rule 12(b)(6) motion to dismiss. *See United States v. Kivanc*, 714 F.3d 782, 789 (4th Cir. 2013).

271 (1985)); *see also 3M Company v. Browner*, 17 F.3d 1453, 1457 (D.C. Cir. 1994) ("'In a country where not even treason can be prosecuted, after a lapse of three years, it could scarcely be supposed, that an individual would remain forever liable to a pecuniary forfeiture.'") (quoting *Adams*, 2 Cranch at 341).

Other cases support the same outcome. In *United States v. Core Laboratories, Inc.*, 759 F.2d 480 (5th Cir. 1985)—decided roughly 30 years before *Gabelli*—the Fifth Circuit interpreted 28 U.S.C. § 2462 in a manner that presaged *Gabelli*. In *Core*, an administrative law judge found violations of the Export Administration Act. The Commerce Department affirmed and imposed a civil penalty. The defendant refused to pay and the government commenced an enforcement action in federal district court. The agency proceeding was commenced within five years of the alleged violations, but the district court action was not. The defendant argued the government's claim was barred by § 2462 and the trial court granted judgment for the defendant on the pleadings.

On appeal, the government argued its claim was timely because the limitations period began to run when the administrative proceedings were complete, not when the underlying conduct occurred. The Fifth Circuit disagreed, stating that "[a] limitations period that began to run only after the government concluded its administrative proceedings would thus amount in practice to little or none." *Id.* at 483. "If the penalty does not accrue [under § 2462] until the United States makes an administrative determination that it is due, the United States has within its power to prolong the period of limitations and the [potential penalty subject] 'would remain indefinitely under the hazard of having penalties imposed upon him . . . .'" *Id.* (citation omitted).

The court in *Core* also relied on an earlier Supreme Court case, *Unexcelled Chemical Corp. v. United States*, 345 U.S. 59 (1953), that construed a similar limitations statute in circumstances analogous to *Core*. *Unexcelled* involved alleged violations of the Walsh-Healy

Act, which authorized the Secretary of Labor to make "investigations and findings," issue "complaints," and "hold hearings." 345 U.S. at 60. The government issued an administrative complaint; a hearing examiner found the company had committed the violations and owed liquidated damages; and that decision became final when it was not timely appealed. *Id.* The government then sued in federal district court to recover the liquidated damages. The company argued that the action was barred by the Act's two-year limitations period. *Id*. at 60-61. The Supreme Court ultimately agreed, rejecting the government's argument that the statute of limitations began to run only after the conclusion of the administrative proceedings. The Court noted that the Act conferred "broad investigatory and hearing powers" on the Secretary, but found that "irrelevant" to when the limitations period began to run, which it found was the date of the alleged violation. *Id*. at 65.[4]

In sum, under *Gabelli* and the other cases discussed above, the passage of five years bars FERC's claim for penalties for alleged violations prior to July 31, 2010.

2. *FERC Cannot Save Its Stale Claims Based on Precedent Recognizing a Second Limitations Period for Penalty Actions That Follow a Statutorily-Mandated Administrative Adjudication*

In responding to this motion, we expect FERC to rely on *United States v. Meyer*, 808 F.2d 912 (1st Cir. 1987). There the First Circuit, addressing specific circumstances not present here, declined to follow *Core*'s holding that 28 U.S.C. § 2462 requires the government to commence a civil penalty enforcement action within five years of the violation. The court in *Meyer* concluded that, if the statute proscribing the predicate violation requires a mandatory administrative adjudication of penalty liability, followed by a federal district court action for recovery after the final administrative order, there is a *second* five-year limitations period for

[4] The Court in *Unexcelled* adopted the same approach the Fourth Circuit took earlier in *Lance, Inc. v. United States*, 190 F.2d 204 (4th Cir. 1951), which the Court cited.

filing an enforcement action after the administrative process has run its course. Under this view, there is *no* limitation on the time between when (i) the agency satisfies the first five-year limitations period by commencing a statutorily-required agency proceeding, and (ii) the clock begins running on the second five-year period. *Meyer* does not save FERC's time-barred claims here for at least two reasons.

(a) Meyer *Does Not Survive* Gabelli

The outcome in *Meyer*—where there are two five-year limitations "clocks," with an unlimited period of time between them—cannot be squared with the Supreme Court's later decision in *Gabelli*. In the limited category of civil penalty cases where *Meyer* might apply, it would transform the five-year limitations period into a period of time falling somewhere between 10 years and infinity. And that outcome must yield to *Gabelli's* ruling that "it 'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'" *Gabelli*, 133 S. Ct. at 1223 (quoting *Adams*, 2 Cranch at 342).[5]

(b) In Any Event, Meyer *Does Not Apply*

Regardless whether *Meyer* survives *Gabelli*, its "two clock" approach does not apply here because that approach is limited to statutes involving a different assessment process. Specifically, *Meyer* recognizes a second limitations period only for actions to recover civil penalties following a statutorily-mandated administrative adjudication of penalty liability. In contrast, here the FPA guaranteed the defendants the choice between an administrative path and

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[5] Although some courts have endorsed the same general view as *Meyer*, they are not good law after *Gabelli*. *See, e.g.*, *United States v. Godbout-Bandal*, 232 F.3d 637 (8th Cir. 2000) (adopting *Meyer*'s approach). In *SEC v. Mohn*, 465 F.3d 647 (6th Cir. 2006), the court was not called upon to analyze the issue because the "parties agree[d] that a claim accrues and the period of limitations begins to run on any collection proceeding to which § 2462 applies once the underlying administrative action establishing liability becomes final." *Id*. at 654.

a judicial one. The defendants chose their day in court. FERC therefore was required by § 2462 to commence this action within five years of the alleged violations.

The details of *Meyer* confirm its inapplicability. In *Meyer*, following an adjudication before an administrative law judge, the Department of Commerce imposed civil penalties against an individual for violating the Export Administration Act ("EAA"). *Meyer*, 808 F.2d at 913. When the individual refused to pay, the Department brought a recovery action in federal district court, as authorized by the EAA, 50 U.S.C. § 2410(f). *Id.* The district court dismissed the case because the Department commenced the court action more than five years after the predicate violations. *Id.* The First Circuit reversed, holding that when "mandatory administrative adjudication" is a statutory prerequisite to bringing a judicial action to enforce the penalty, and the agency adjudication was timely commenced within five years of the alleged misconduct, a second limitations period begins to run after "a final (administrative) decision." *Id.* at 920-22.

Meyer therefore applies—if at all—only to statutes providing for "mandatory administrative adjudication." When that mandatory agency adjudication is complete, *Meyer* would provide a second limitations period. But *Meyer* pointedly distinguished (i) statutes providing for mandatory agency adjudication from (ii) ones that provide for the agency to make "prosecutorial determinations," which *Meyer* deemed irrelevant to the limitations analysis:

> Administrative determinations of [the prosecutorial] ilk, however necessary they may be to the prosecution of enforcement actions, are not in any sense adjudicative. At bottom, they comprise nothing more or less than decisions to bring suit. In significant contrast to the adjudicative administrative proceedings required before EAA penalties may be imposed and enforced, these determinations fall entirely within the suzerainty of the government. Were the statute of limitations to run against, say, an F.T.C. action, the Commission would have only its own indecision to blame. The EAA analogue to this kind of administrative prerequisite is not the imposition of a statutory penalty by an [administrative law judge] after notice, discovery, and hearing; rather, it is the Department's initial issuance of a charging letter. No one disputes that the limitations period on wholly administrative action runs from the time of the underlying violation rather than from the government's decision to prosecute the

> charge. Indeed, if statutes of limitations did not begin running until a party resolved to bring suit or otherwise take affirmative action to vindicate its rights, no statute of limitations would ever lapse; the promise of repose would be as empty as a beggar's purse. To liken prosecutorial decisionmaking to mandatory administrative adjudication is to compare plums with pomegranates.

Id. at 920-21.

Under the governing statutory scheme here, and in stark contrast to *Meyer*, FERC was not statutorily authorized to adjudicate the defendants' liability. The defendants did not elect the administrative path, which authorizes FERC to make a "determination," required to be "on the record" under the Administrative Procedure Act. Instead, the defendants elected the court path, which means FERC has statutory authority to do only two things: (1) promptly assess a penalty and (2) file an action in federal district court if it is not paid within 60 days. 16 U.S.C. § 823b(d)(3). FERC's assessment order thus is directly analogous to the "prosecutorial decisionmaking" that *Meyer* correctly labeled as "nothing more or less than decisions to bring suit." 808 F.3d at 920.[6] It is this court that is statutorily charged with adjudicating the defendants' liability in the first instance—just as the court adjudicates any other civil action.[7]

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[6] FERC's assessment order has no independent legal significance. It did not affix any rights. That follows inescapably from FERC's own statement in the assessment order that the defendants had no right to seek rehearing from FERC. Compl. Ex. 1 ¶ 193. And because rehearing is a statutory prerequisite for seeking judicial review in any other FERC case, the defendants had no opportunity to petition a court for judicial review. *See* 16 U.S.C. § 825*l*, and discussion, *supra* pp. 5-6. Given that neither the FPA nor the assessment order leave the defendants any ability to seek redress for agency error, it makes no sense to view the assessment order as having any binding force and effect. It is a bedrock principle of administrative law that, absent a clear congressional statement to the contrary, agency action that aggrieves a party is subject to judicial review. 5 U.S.C. § 702; 16 U.S.C. § 825*l*. Because the assessment order is not a final administrative determination, *Meyer*—by its own terms—does not apply.

[7] This statutory division of responsibility is not uncommon. Many federal statutes similarly require a federal district court adjudication of an agency's civil penalty claims and do not authorize the agency to execute the adjudicatory function in those matters. *See e.g.*, *3M Co.*, 17 F.3d at 1459 ("§ 2462's application to cases in which the court first adjudicates liability and then sets the penalty or fine is unquestioned"); *Athlone Indus., Inc. v. Consumer Prod. Safety*

(cont'd)

Because the defendants exercised their statutory right to a federal district court action, FERC's role is limited to prosecuting its claims. It had no statutory authority to adjudicate them. Conduct more than five years prior to this action therefore is barred by 28 U.S.C. § 2462. *Gabelli*, *Unexcelled*, *Core*, and *Lance* compel this outcome; *Meyer* does too.

B. FERC's Claim for Disgorgement Is Time-Barred to the Same Extent as Its Penalty Claims

FERC's assessment order purports to require the defendants to disgorge allegedly unjust profits. Compl. ¶ 12. FERC's claims for disgorgement based on conduct prior to July 31, 2010, should be dismissed as time-barred under 28 U.S.C. § 2462.

Disgorgement is an equitable remedy, and the Supreme Court has long held that "equity will withhold its relief in such a case where the applicable statute of limitations would bar the concurrent legal remedy." *Cope v. Anderson*, 331 U.S. 461, 464 (1947) (citing *Russell v. Todd*, 309 U.S. 280, 289 (1940)). Although the Fourth Circuit has not addressed this "concurrent remedy" rule in cases involving 28 U.S.C. § 2462, the Ninth Circuit relied on it to bar a claim for equitable relief based on § 2462. *See Federal Election Comm'n v. Williams*, 104 F.3d 237, 240 (9th Cir. 1996) ("[B]ecause the claim for injunctive relief is connected to the claim for legal relief, the statute of limitations [§ 2462] applies to both."); *see also United States v. EME Homer City Generation, L.P.*, 727 F.3d 274, 295-96 (3d Cir. 2013) (rejecting claim for injunctive relief because requiring the defendants to "purchase and retire emissions credits" would be "an end-run around [§ 2462's] five-year statute of limitations on 'any civil fine, penalty, or forfeiture, pecuniary or otherwise.'").

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Comm'n, 707 F.2d 1485, 1492 & n.46 (D.C. Cir. 1983) (stating that although Congress "can, if it wishes, authorize [an administrative penalty assessment]," Congress often limits agencies to "a prosecutorial role in civil penalty actions").

We note that some courts have reached a contrary conclusion. *See, e.g.*, *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (holding that disgorgement claims are not subject to limitations period in § 2462); *SEC v Kelly*, 663 F. Supp. 2d 276, 286-87 (S.D.N.Y. 2009) (same). But those cases did not address the Supreme Court precedent the Ninth Circuit relied on in *Williams*. And they also conflict with *Gabelli* because, unless there is a point in time when the government's claims become stale, the concerns in *Gabelli* are implicated.

That conclusion is supported by a recent district court case where the Securities and Exchange Commission ("SEC") was pursuing claims for disgorgement and civil penalties, as well as declaratory and injunctive relief, and the court dismissed with prejudice the government's entire case, including disgorgement and other equitable claims, on grounds that it was untimely under 28 U.S.C. § 2462. *SEC v. Graham*, 21 F. Supp. 3d 1300 (S.D. Fla. 2015). The court analyzed *Gabelli* at length and concluded that the "principles underlying [that] decision" required the court to reject the SEC's argument that no statute of limitations applied to its claims for disgorgement and other remedies.[8] The court reasoned that "[p]enalties" were "at the heart of all forms of relief sought by the SEC," and disgorgement—in particular—"can truly be regarded as nothing other than a forfeiture (both pecuniary and otherwise), which remedy is expressly covered by § 2462. To hold otherwise would be to open the door to Government plaintiffs' ingenuity in creating new terms for the precise forms of relief expressly covered by the statute in order to avoid its application." 21 F. Supp. 3d at 1310-11.[9]

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[8] In *Gabelli*, the Supreme Court noted that the district court found the SEC's claims for disgorgement and injunctive were not subject to § 2462. The Court stated "[t]hose issues are not before us," 133 S. Ct. at 1220 n.1, which suggests the Court might have reached a contrary conclusion if those issue had been presented.

[9] The Eleventh Circuit came to a contrary conclusion about the applicability of § 2462 to at least certain types of equitable remedies in an earlier case, *United States v. Banks*, 115 F.3d 916

(cont'd)

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For these reasons, FERC's claims about trades prior to July 31, 2010 are time-barred.[10]

II. *THE COMPLAINT DOES NOT STATE A CLAIM FOR MARKET MANIPULATION*

A. *Overview of Legal Standards*

1. *Dismissal Lies When the Complaint Does Not State a Claim*

On a motion to dismiss for failure to state a claim, the court must accept a plaintiff's well-pled allegations as true and view the complaint in the light most favorable to the plaintiff. *Mylan Labs., Inc. v. Matkari*, 7 F.3d 1130, 1134 (4th Cir. 1993). However, to survive a motion to dismiss pursuant to Rule 12(b)(6), "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). To be "plausible on its face," a plaintiff must demonstrate "more than a sheer possibility that a defendant has acted unlawfully." *Iqbal*, 556 U.S. at 678. "[T]he Supreme Court has held that a complaint must contain 'more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.'" *Francis v. Giacomelli*, 588 F.3d 186, 193 (4th Cir. 2009) (quoting *Twombly*, 550 U.S. at 555) "'[N]aked assertions' of wrongdoing necessitate some 'factual enhancement' within the complaint to cross 'the line between possibility and plausibility of entitlement to relief.'" *Id.* (quoting *Twombly*, 550 U.S. at 557).

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(11th Cir. 1997). However, the judge in *Graham* distinguished *Banks* as involving "the United States in its sovereign capacity [seeking] to enforce the Clean Water Act . . . to enjoin the discharge of fill into U.S. waters" instead of a plaintiff seeking disgorgement—a remedy the *Graham* court found susceptible to statutes of limitations. 21 F. Supp. 3d at 1310.

[10] The complaint does not actually allege any specific trades on any specific dates, so it is unclear whether FERC is asserting claims for all or any of those last four days of the alleged Manipulation Period. This boldly underscores the glaring pleading deficiencies, discussed in part II of this brief, that require the compliant to be dismissed in its entirety.

2. *The FPA's Prohibition on Market Manipulation Requires FERC to Establish Fraud*

FPA § 222 prohibits fraud-based market manipulation:

> It shall be unlawful for any entity . . . to use or employ, in connection with the purchase or sale of . . . services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b))), in contravention of such rules and regulations as the Commission may prescribe . . . .

16 U.S.C. § 824v. Congress patterned this FPA provision directly on § 10(b) of the Securities Act, which reads:

> It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . .

15 U.S.C. § 78j. The two provisions are nearly identical, and Congress codified the obligation to interpret them *in pari materia* by requiring "any manipulative or deceptive device or contrivance" to be read as those terms are used in Securities Act § 10(b).[11]

The Supreme Court has explicitly defined the boundaries of a fraud claim under Securities Act § 10(b)—and by statute that definition also governs claims under FPA § 222. In *Chiarella v. United States*, 445 U.S. 222 (1980), the Supreme Court stated that "[s]ection 10(b) is aptly described as a catchall provision, but what it catches *must be fraud*." *Id.* at 234-35 (emphasis added). The Court explained that fraud requires either a "misrepresentation made for

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[11] When FERC promulgated a rule to implement FPA § 222, it stated that the "anti-manipulation sections of EPAct 2005 closely track the prohibited conduct language in Section 10(b)" and, consequently FERC "modeled the Final Rule on Rule 10b-5," (the SEC's parallel regulation) "[c]onsistent with the mandate that certain aspects of the [plaintiff's] new authority be exercised in a manner consistent with Section 10(b) of the Exchange Act." *See* Order No. 670, FERC Stats. & Regs. ¶ 31,202 at PP 6-7. FERC also observed that "a significant body of legal precedent concerning Section 10(b) of the Exchange Act and Rule 10b-5 has developed" which would "provide a level of substantial certainty" in applying the new rule. *Id.* at PP 7, 30.

the purpose of inducing reliance" or, when there is a duty to speak, a "fail[ure] to disclose material information prior to the consummation of a transaction." *Id.* at 227-28.

3. *The Heightened Pleadings Standard in Federal Rule of Civil Procedure 9(b) Governs FERC's Fraud Claims*

Federal Rule of Civil Procedure 9(b) requires heightened pleading standards for fraud allegations. Fed. R. Civ. P. 9(b). FERC's claims for alleged market manipulation therefore must "state with particularity the circumstances constituting fraud."[12] *Id.*

B. *FERC's Allegations of Fraud Fail—Both as a Matter of Law and Because They Have Not Been Plead With Particularity*

The complaint includes only four paragraphs purporting to allege market manipulation: Paragraphs 80-83. Paragraph 80 merely summarizes the next three. Each of those three paragraphs (1) rests on invalid propositions of law and (2) fails to satisfy Rule 9(b).

1. *Complaint Paragraph 81's Allegation That Offsetting Trades "Falsely Appeared to PJM as Legitimate" Does Not Survive Scrutiny*

Paragraph 81 reads as follows:

> The Commission found that Respondents' "round-trip UTC transactions were deceptive and manipulative" because they 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. Order at P 5.

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[12] *Id.* Rule 9(b) applies to fraud allegations under the Securities Act. *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618, 629 (4th Cir. 2008). Under Rule 9(b), "[a]lthough states of mind may be pleaded generally, the 'circumstances' must be pleaded in detail. This means the who, what, when, where, and how: the first paragraph of any newspaper story." *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990). "[L]ack of compliance with Rule 9(b)'s pleading requirements is treated as a failure to state a claim under Rule 12(b)(6)." *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 783 n.5 (4th Cir. 1999).

(a) Paragraph 81's Legal Flaws

This paragraph fails to state a claim for fraud. FERC cannot allege misrepresentation because, as Enforcement Staff recognized, the defendants' trades "did not involve any false statements, active concealment, or other explicit tariff violations." Compl. Ex. 2, App. A at 50. So the complaint instead assumes the existence of a requirement to engage only in what are called "legitimate" or "routine arbitrage-based" up-to congestion trades. It also assumes the existence of a binding requirement to make some sort of representation to PJM regarding whether trades fit into this "legitimate" category. But FERC has not, and cannot, establish that any such rules ever existed prior to the trading at issue. The complaint never provides any source for any such rules in any prior Commission order, regulation, or PJM market rule. Nor does FERC's assessment order.

And that is because there never was any prior requirement that up-to congestion traders engage only in "arbitrage-based" transactions. To the contrary, as the assessment order itself points out, when FERC first approved the creation of up-to congestion trading in PJM, it did so to allow market participants *not* to engage in arbitrage, but to hedge price-spread risks. Compl. Ex. 1 at PP 18-19. Not only was there no prior rule precluding transactions that offset or hedged price-spread exposure, but offsetting that exposure was the reason the Commission created up-to congestion trading to begin with. And there similarly was no prior requirement that up-to congestion traders represent anything to PJM about the purposes of their trades.

As we explain in the next section of this brief, the lack of prior notice of these newly-announced "requirements" poses grave constitutional concerns. For present purposes it is enough to observe that FERC cannot state a claim for fraud by alleging that the defendants somehow concealed their failure to comply with requirements that never existed to begin with. It is legally impossible to deceive anyone about not complying with a non-existent requirement.

(b) Paragraph 81's Pleading Flaws

Paragraph 81 also fails to plead fraud with particularity. *First*, it does not actually allege that the defendants did anything. Instead it alleges that FERC "found" various things. These are different; alleging findings by FERC does not allege conduct by the defendants. Accordingly, FERC has necessarily failed to plead fraud in satisfaction of Rule 9(b). Absent allegations of particular statements, times or trades, FERC has failed to provide the necessary "what, when, where, and how." *DiLeo*, 901 F.2d at 627.

Second, "pleading requires more than labels and conclusions." *McCleary-Evans v. Md. Dept. of Transp.*, 780 F.3d 582, 585 (4th Cir. 2015) (quoting *Twombly*, 550 U.S. at 555). A complaint therefore "must contain factual allegations sufficient to raise a right to relief above the speculative level." *Id.* (internal quotation marks, alterations and citations omitted). The circular reasoning and unfounded legal conclusions in Paragraph 81—the trades were illegitimate, therefore they falsely appeared to be legitimate—fail that test.

2. Complaint Paragraph 82's Allegation That Defendants "Impaired, Obstructed, or Defeated a Well-Functioning Market" Does Not Survive Scrutiny

Paragraph 82 reads as follows:

> In finding that Respondents' round-trip trades were fraudulent and manipulative because they impaired, obstructed, or defeated a well-functioning market, the Commission noted that "our use of 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.* P 49 (citing 16 U.S.C. § 824v).

(a) Paragraph 82's Legal Flaws

FERC's effort to expand the definition of fraud to include impairing or obstructing a well-functioning market has two fatal legal flaws.

First, that standard has no statutory basis because it violates the Supreme Court's requirement that "what [§ 10(b)] catches must be fraud," *Chiarella*, 445 U.S. at 235, which applies with equal force here in view of FPA § 222's express incorporation of the operative language from § 10(b). In direct contravention of the Supreme Court's directive, FERC claimed, in its order adopting the purported "impairing a market" standard, "that fraud within the meaning of a statute need not be confined to the common law definition of fraud: any false statement, misrepresentation or deceit." Compl. Ex. 1 at P 49 (citing Order No. 670, FERC Stats. & Regs. ¶ 31,202 at P 50 & n.103). But FERC has no authority to redefine what the statute requires.

FERC's highly elastic view of fraud also is based on a misreading of *Dennis v. United States*, 384 U.S. 855, 861 (1966), which involved a statute prohibiting conspiracies to defraud the United States. Among other things, the court said that this statute encompassed "'any conspiracy for the purpose of impairing, obstructing, or defeating the lawful function'" of the government. 384 U.S. at 861 (citations omitted). FERC simply paraphrases this language, claiming that fraud under its statute includes "impairing, obstructing or defeating a well-functioning market." Order No. 670, FERC Stats. & Regs. ¶ 31,202 at P 50.

Dennis contradicts FERC's effort. The defendants in *Dennis* were charged under the conspiracy statute for filing false affidavits denying membership in the Communist Party. Fraud therefore *was a given*—the defendants deliberately lied about being communist. The only question in *Dennis* was whether, in addition to lying, the defendant's *also* conspired to obstruct the government. *Dennis*, 384 U.S. at 861-62. *Dennis* therefore does not support FERC's effort to escape the requirement that it plead (and ultimately prove) fraud.

The Ninth Circuit has squarely rejected the same theory FERC urges here. In *United States v. Caldwell*, 989 F.2d 1056 (9th Cir. 1993), the government sought to remove the deceit requirement from the conspiracy statute by advancing the position that "*any* conspiracy to obstruct a government function is illegal, even if the obstruction is not done deceitfully or dishonestly." *Id.* at 1059. The government claimed that "'if what you're doing, legal or illegal, is intended to impede and impair the Internal Revenue Service, . . . that constitutes a crime under [the conspiracy statute].'" *Id.* (quoting oral argument). The court resoundingly rejected that position: "Obstructing government functions in other [non-deceitful] ways—for example, by violence, robbery or advocacy of illegal action—can't constitute 'defrauding.'" *Id.* at 1060. *See also United States v. Knapp*, 25 F.3d 451, 455 (7th Cir. 1994) (noting that *Hammerschmidt v. United States*, 265 U.S. 182 (1924), and *Caldwell* "stand for the proposition that a defendant cannot be found guilty of defrauding the United States without some showing of fraud").

The court colorfully explained why:

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

Caldwell, 989 F.2d at 1061.

So too here. The trades at issue were not deceptive and are not fraudulent under FERC's statutory scheme.

FERC presumably will argue, in response, that these arguments are collateral attacks on the rulemaking preamble that adopted the "impairing the market" language. In its assessment order, FERC relied on this collateral attack argument to sidestep any defense of its authority to claim that "impairing a market" is fraud. *See* Compl. Ex. 1 at P 118. But any such contention misses the mark by a wide margin. The defendants have the right to challenge FERC's regulations on an as-applied basis (not just on a facial basis). *See, e.g.*, *Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822, 827 (D.C. Cir. 2006). FERC's contrary claim merely highlights its lack of any colorable response on the merits.

Third, FERC's allegation that the defendants "intentionally subvert[ed] the allocation of payment" fails as a matter of law because FERC had, when the trading occurred, repeatedly held that no one was entitled to any specific share of the loss credits. *Black Oak Energy, LLC v. PJM Interconnection, L.L.C.*, 125 FERC ¶ 61,042 at P 46 (2008). As the complaint explains, loss credits were paid as compensation to up-to congestion trades that involved payment of PJM transmission charges. Compl. ¶ 45. The defendants paid transmission charges in connection with all loss credits they received. There can be no "subver[sion]" of any "allocation" of loss credits when the defendants fulfilled the one and only condition for receiving those credits. It is legally impossible to "subvert" an allocation that never existed to begin with.

(b) Paragraph 82's Pleading Flaws

As with paragraph 81, this paragraph alleges that FERC made a "finding," not that the defendants did anything. In addition, the only part of this paragraph that could be read to address fraudulent conduct or a misrepresentation is the last sentence about "intentionally subverting the allocation" of loss credits. But FERC cannot plead that fraud claim with particularity without ever explaining what the allegedly subverted allocation is, and when it was created. In any case,

FERC has failed to plead the specific time, place, and statements required by Rule 9(b), *DiLeo*'s "what, when, where, and how." 901 F.2d at 627.

3. Complaint Paragraph 83's Allegation That Defendants Engaged in Wash Trades Does Not Survive Scrutiny

Paragraph 83 reads as follows:

> The Commission found that Respondents' round-trip UTC trades were wash trades: "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 as previously articulated, trades that are pre-arranged to cancel each other out and involve no economic risk are wash trades, which are inherently fraudulent." *Id.* P 6 (citing *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218, at P 53 (2003)).

(a) Paragraph 83's Legal Flaws

This paragraph also fails to state a claim for which relief can be granted. Paragraph 83 sets forth only part of FERC's pre-existing prohibition of wash trades. The Supreme Court recently gave a more complete recounting in *ONEOK, Inc. v. Learjet*, 135 S. Ct. 1591 (2015). There the Supreme Court explained FERC's prohibition against wash trades as barring "'prearranged pairs of trades of the same good between the same parties involving no economic risk and no net change in beneficial ownership.'" *Id.* at 1597 (quoting FERC, *Final Report on Price Manipulation in Western Markets*, App. at 215 (Mar. 2003)) (internal alterations omitted).

FERC's allegations fail that well-established definition. Because real wash trades do not involve any economic risk, they do not, in and of themselves, either make or lose money. The disputed trades both made and lost money, and therefore necessarily involved economic risk. We see that on the face of the complaint, which alleges that the total loss credits flowing from the disputed transactions was approximately $10.1 million. Compl. ¶ 79. The complaint also alleges that the disputed trades made net profits—total loss credits minus transaction costs—of

over $4.7 million. *See id.* at (E)–(G). These trades did not offset. Far from it; they made substantial sums of money.

In addition, the disputed trades involved changes in beneficial ownership. The defendants paid fixed transmission and other transaction charges—which became the property of PJM—and received the right to floating levels of loss credits, which became their property. These transactions were classic fixed for floating swaps, which have real economic substance.[13]

At bottom, FERC's wash-trade allegation is that a sub-part of the disputed trades—what FERC calls "price risk" or "price spreads"—cancelled each other out. But FERC's pre-existing wash-trade definition did not parse sub-parts of costs or revenue. Where, as here, total revenue and total costs do not cancel each other out, and the trades have real economic substance—sometimes making money, sometimes losing money, but over time making significant overall profits—there is no basis in the law to allege that they are wash trades.[14] And that conclusion is all the more inevitable here, where offsetting price-risk exposure—which FERC now claims amounts to unlawful wash trading—was FERC's original purpose for creating up-to congestion trading. *See* Compl. Ex. 1 at PP 18-19.

(b) Paragraph 83's Pleading Flaws

As with paragraphs 81 and 82: (i) this paragraph alleges that FERC made a "finding," not that the defendants did anything; and (ii) there is no specification of precisely which trades are considered illegitimate—no "what, when, where, and how," *DiLeo*, 901 F.2d at 627.

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[13] *See Caisse Nationale de Credit Agricole v. CBI Indus., Inc.*, 90 F.3d 1264, 1267 (7th Cir. 1996) (describing "swaps" as "agreements to exchange fixed-rate and floating-rate interest obligations" in which "[o]ne party pays interest . . . at a fixed rate; the other at a floating rate").

[14] Enforcement staff apparently agreed that the disputed trades did not fit within FERC's pre-existing definition of wash trades, eventually resorting to calling them "wash-like." *See* Compl. Ex. 1 at P 101 & Ex. 2 at 50-58, 70.

III. FERC'S NEWLY-MINTED DISTINCTION BETWEEN "LEGITIMATE" AND "ILLEGITIMATE" UP-TO CONGESTION TRADES VIOLATES THE CONSTITUTIONAL DUE PROCESS REQUIREMENT OF CLEAR PRIOR NOTICE

"A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012). This "requirement of clarity in regulation is essential to the protections provided by the Due Process Clause of the Fifth Amendment." *Id.*

Clear prior notice is particularly important in civil penalty cases. As the Fourth Circuit has explained, because "civil penalties are 'quasi-criminal' in nature, parties subject to such administrative sanctions are entitled to similar 'clear notice'" to that required in criminal cases. *United States v. Hoechst Celanese Corp.*, 128 F.3d 216, 224 (4th Cir. 1997) (citing *First Am. Bank of Va. v. Dole*, 763 F.2d 644, 651 n.6 (4th Cir. 1985)); *see also Gen. Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (stating that the fair notice doctrine, which had originated in criminal proceedings "has now been thoroughly incorporated into administrative law") (internal quotation marks omitted). Determining clear notice is an objective inquiry which asks whether the government provided sufficiently specific and unambiguous warning so as to "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited." *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972). The law is clear: the fair notice doctrine requires more than after-the-fact determinations of what the government considers unlawful.

FERC fails that test. FERC purports to prohibit what it now calls "illegitimate" up-to congestion trading. But FERC nowhere roots that alleged rule in any prior pronouncement by FERC or any court. And that is fatal. The fair notice doctrine bars FERC from claiming that the defendants violated a rule that FERC never announced until after the fact.

That would be enough to bar this action on constitutional grounds. But FERC's case here is weaker still. For here FERC actually predicted, in advance, precisely the conduct it now

claims was unlawful. It predicted that paying loss credits would "creat[e] an incentive for arbitrageurs to engage in purchase decisions, not because of price divergence, but simply to increase line loss payments." *Black Oak Energy,* 125 FERC ¶ 61,042 at P 43; *see also Black Oak Energy, LLC v. PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,208 at P 51 (2008) (If loss credits are paid to up-to congestion traders, they "may make trades that would not be profitable based solely on price differentials alone"). That is exactly what FERC now claims is unlawful.

Although FERC very precisely predicted that traders would follow the incentives it created by requiring loss credits to be paid as compensation for up-to congestion trades, it said not one single word to warn the defendants or anyone else not to pursue that incentive.[15] The conduct that FERC now alleges was fraudulent was not only predictable, but was predicted, in advance, by FERC itself. Yet FERC never took the simple step of adding even one sentence prohibiting that conduct.[16] And retroactively imposing that bar now is unconstitutional.[17]

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[15] FERC's failure to warn is all the more inexcusable in light of the fact that it routinely issues such warnings to independent transmission system operators and market participants in its orders. *See, e.g.*, *Midwest Indep. Transmission Sys. Operator, Inc*., 137 FERC ¶ 61,213 at P 87 (2011) (discussing concerns that proposed "reference levels" will encourage manipulation and stating that "the Market Monitor will be monitoring the behavior of resources of all affiliates . . . and can refer such behavior to the Commission"); *Cal. Indep. Sys. Operator Corp.*, 132 FERC ¶ 61,045 at P 66 (2010) (identifying "[m]anipulation concerns in the Proxy Demand Resource proposal" and finding CAISO proposal adequately addresses such concerns, including through "accurate customer baseline calculations, monitoring and verification measures and certain deterrent provisions").

[16] In our view, it would be terminally arbitrary for the government to bestow a revenue stream on traders, then rule that it is fraud to seek to collect that revenue. It is hard to imagine a court acting on direct review affirming such a contrary act, when the obvious solution is not to pay the revenue stream to begin with. It is even harder, however, to imagine the government surviving court scrutiny if it sought to impose such a counterintuitive rule after the fact. Yet that is exactly what FERC seeks here.

[17] FERC also failed to provide the notice required for it to find culpability based on the receipt of loss credits that, "'but for their trades, would have gone to other market participants.'" Compl. ¶ 46 (quoting Ex. 1 at P 70). This "harm" cannot possibly be a basis for liability since

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The Fourth Circuit has rejected an agency's attempt to impose a penalty under very similar circumstances. In *First American Bank*, the Civil Aeronautics Board sought to impose a penalty for the defendant's failure to monitor a charter company's bank accounts, despite the fact that no affirmative duty to monitor had ever been promulgated. Just like this case, the Board in *First American Bank* had considered, but chose not to implement, such a rule. The Fourth Circuit rejected the penalty, stating that the Board "never exercised the caution and circumspection so clearly called for when it imposed civil penalties on First American Bank for the violation of a duty that its own regulations neither contemplated nor established." *First American Bank*, 763 F.2d at 651-52. So too here. FERC cannot sanction conduct that it may have considered but failed to prohibit in advance.

Apparently realizing its vulnerability, FERC advocates an unsupported, new, and radical view of the fair notice doctrine. In stark disagreement with both the Supreme Court and the Fourth Circuit, FERC stated in its assessment order that "[w]hen it is unclear whether conduct would be legal, the risk associated with pursuing that conduct falls on the market participant." Compl. Ex. 1 at P 122. But that is not the law. Under *Fox Television* and *Hoechst Celanese*, market participants are not expected to divine what an agency meant to (or should have) said; nor are they required to suffer an agency's post-hoc revisions of the law.

In sum, FERC may wish that it had prohibited the disputed trading before the fact, when it predicted that such trading would occur. But it did not. And it cannot now un-ring that bell.

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FERC had explicitly found that "no party within PJM is entitled to receive any particular amounts through disbursement of the over-collections" of loss credits. *Black Oak Energy*, 122 FERC ¶ 61,208 at P 46 (citing, *inter alia*, *Atl. City Elec. Co. v. PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,132 at P 24 (2006)).

IV. NO CLAIM LIES AGAINST DR. CHEN BECAUSE THE FPA DOES NOT AUTHORIZE MANIPULATION CLAIMS AGAINST INDIVIDUALS

FPA § 222 states that "[i]t shall be unlawful for any entity" to commit market manipulation. 16 U.S.C. § 824v(a). FERC cannot raise a claim against Dr. Chen because the term "entity" does not encompass natural persons. The FPA fails to define "entity," and the word therefore receives its "ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). And a "person" is not an "entity" in common parlance.[18]

Reflecting this, Congress acted expressly and unmistakably to ensure that § 222 would not apply to natural persons. As noted above, § 222 of the FPA closely clones § 10(b) of the Securities Act. The operative language is identical, with *one exception*: the identified *target* of FERC's anti-manipulation authority. While the Securities Act proscribes market manipulation by "any person," 15 U.S.C. § 78j, § 222 proscribes it for "any entity," 16 U.S.C. § 824v(a).

That ends the debate. It is black letter law that "[w]hen Congress acts to amend a statute, . . . it intends its amendment to have real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995). Because Congress expressly rejected the option of proscribing manipulation by a "person," the claims against Dr. Chen must be dismissed.

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[18] The common meanings of "entity" include "the essence, fundamental nature, or real being of something," and "something that has objective or physical reality and distinctions of being and character," they do not include natural persons. ENTITY, *Webster's Third International Dictionary* 758 (1981); *accord Fox Television*, 132 S. Ct. at 2317 (recognizing "persons" and "entities" as separate, alternative subjects of regulation); *Am. Dental Assn v. Shalala*, 3 F.3d 445, 446, 447 (D.C. Cir. 1993) (concluding that the undefined statutory term "entity" did not include "individual persons" because the act "uses terms other than 'entity' whenever referring to individuals"). *Accord* ENTITY, *Black's Law Dictionary* 650 (10th ed. 2014).

CONCLUSION

For all of the reasons set forth herein, the defendants respectfully submit that FERC's complaint should be dismissed with prejudice.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 19, 2015, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system, which shall send notification of such filing to counsel receiving notices in this matter, including the following counsel of record:

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