UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Houlian Chen	)	**Docket No. IN15-3-000**
Powhatan Energy Fund, LLC	)	
HEEP Fund, Inc.	)	
CU Fund, Inc.	)	

ANSWER IN OPPOSITION TO EXPEDITED MOTION FOR TWO-WEEK EXTENSION OF TIME

On January 27, 2015, Houlian Chen, CU Fund, Inc., Powhatan Energy Fund, LLC and HEEP Fund, Inc. (collectively, Respondents or Movants) submitted an "Expedited Motion for a Two-Week Extension of Time" (Motion). The Motion seeks an extension of two weeks, from February 2, 2015 to February 16, 2015, to file their Answer to the Order to Show Cause issued in this proceeding.[1] For the reasons discussed below, the Motion is without merit and the Commission should deny it.

I. Argument

The central argument of the Motion is that Enforcement staff is in possession of certain materials – specifically, voice recordings and simulated Marginal Loss Surplus Allocation (MLSA) reallocation simulations performed by PJM – that Movants contend are (or may be) "exculpatory" and thus covered by the Commission's *Policy Statement on Disclosure of Exculpatory Materials* (which Movants refer to as the "*Brady* Policy").[2] The Motion implies, without stating so directly, that Movants will be materially prejudiced in their ability to submit a timely answer to the Order to Show Cause on February 2, 2015 because they do not yet have these materials.

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1 *Houlian Chen, Powhatan Energy Fund, LLC, HEEP Fund, Inc., and CU Fund, Inc.*, 149 FERC ¶ 61,261 (2014).

2 129 FERC ¶ 61,248 (2009).

The Motion is misleading and wrong. Although Movants misconstrue in several ways what the Commission's *Brady* Policy requires, the fundamental point is a simple one: to the extent the materials referenced in the Motion are relevant to Movants, they are *inculpatory*, not exculpatory.

Enforcement staff is submitting these materials with this Answer, along with other relevant documents. Staff submits the voice recordings on a protected, non-public basis because they involve individuals and entities that have not been charged with committing potential violations at this time. However, if the Commission determines, in the interest of transparency, that all of these materials be made public, staff does not object to such disclosure.

A. The Voice Recordings

Respondents state,

> on information and belief, that Enforcement possesses a voice tape, produced to it in another investigation, in which Dr. Joe Bowring of Monitoring Analytics (the PJM Independent Market Monitor), talks to traders at another company that engaged in transactions similar to the ones Enforcement challenges here. On that tape, Dr. Bowring says that the trades did not violate the rules, that he understands why the traders engaged in them, and that the rules need to be changed to remove the incentives that drove the trading.[3]

Movants contend that the audio recording is exculpatory because, they claim, "any statement that [Bowring] would not refer the traders if they stopped the trades at issue suggests that Dr. Bowring must have thought, at that time, that the trading at issue was not market manipulation."[4] Movants contend that this audio recording is therefore "favorable" to them or "would tend to exculpate [them] or reduce the penalty."[5]

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[3] Motion at 1. Movants do not state when they obtained this "information" or formed this "belief."

[4] Motion at 2 (emphasis in original).

[5] Motion at 2, *citing Brady v. Maryland*, 373 U.S. 83, 87-88 (1963).

1. The July 27, 2010 Voice Recording Is Not Exculpatory

Enforcement Litigation staff believes it has identified the audio recording referenced in the Motion[6] of a conversation among Joe Bowring and John Dadourian of Monitoring Analytics and a trader with a different company on July 27, 2010.[7] This conversation, submitted herewith as Attachment B-1, relates to the behavior of another market participant and is not remotely exculpatory of Movants' conduct.

First, the fact that the Independent Market Monitor (IMM) expressed the view that Unnamed Company's Up-To Congestion (UTC) trades did not violate the tariff in this call cannot be exculpatory, because Enforcement staff has never alleged that Movants' UTC trades violated the tariff. Since there is no allegation that the trades violated the tariff, even if Bowring had been discussing Movants' round-trip UTC trades (which he was not), his opinion that the practice did not violate the tariff is not exculpatory or even relevant to the matters at issue in this proceeding.

Second, far from being exculpatory, Bowring's comments about Unnamed Company's SOUTHIMP/SOUTHEXP trading strategy[8] are entirely consistent with the

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6 Movants did not mention this, or any other voice recording, to staff until Monday, January 26, 2015. *Cf.* Motion at 1 ("We called Enforcement staff mid-day on Friday to explore their failure to produce the material discussed below . . ."). That may have been the purpose of the call, but that purpose was not disclosed to staff.

7 Because the trader and his company have not been alleged to have engaged in market manipulation, this Answer refers to them as "Unnamed Trader" and "Unnamed Company". Attachment B-1. This recording appears to have been made in Pennsylvania, which requires consent of both parties before one party records the call. There is no indication that the IMM consented to these recordings.

8 Unlike Movants' round-trip UTC trading strategy, the SOUTHIMP/ SOUTHEXP trading strategy was a single path strategy. On a single path, it is at least theoretically possible for there to be price spreads between points A and B, and in fact, Unnamed Trader both (i) claims that he has seen such price separation in the past and (ii) concedes that trading UTCs with no price spread is inappropriate. *See* Attachment B-1 ("if you look at the history, the pricing history . . . there are many occasions where, where those

market manipulation allegations underlying Staff's Report: while this trading strategy may not violate the tariff, it is illegitimate because it is designed to exploit market rules and make money from the capture of MLSA without taking a bona fide position in the market. In the July 27 conversation, Bowring explained that, "our concern is that . . . these transactions are really just designed to . . . arbitrage the difference between transmission rates and . . . the marginal losses compensation, and, that's not really a legitimate reason to engage in the transaction."[9] In response to Unnamed Trader's comment that "the trades on their own do have a potential for profit," Bowring explained:

> Right, so right, right. Exactly. So, but, so we think that's an example of . . . gaming the rules and that's . . . not a reason consistent with the underlying reason the market is structured the way it is and . . . I understand that it is a profit opportunity, but we think it's a . . . non-legitimate one. So we wanted to tell you that, see what your reaction was and then, and obviously . . . we can't make you stop, but if you choose not to stop, then, you know, our next recourse is to talk to FERC about it . . . . and ultimately, ultimately, to try to get . . . the rule changed because, I mean, it's incenting this behavior which is designed to make money from the fact that we have this weird discontinuity in the rules and I understand why your traders would be doing it, but I think you can also understand why we don't think it, it represents anything about the economic fundamentals.[10]

In response to Unnamed Trader's question about "where you draw the line," Bowring explained:

> *I think the line is pretty easy to draw. And that is, . . . if engaging in the transaction itself results in a profit because you're buying it for less than you're selling it for, that's legitimate. If . . . the only reason you're making money from the transaction is because you're buying and selling at the*

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things have diverged . . .") and B-2 ("the trades specifically that we . . . think are inappropriate are the ones that don't have any price delta."). Movants' round-trip trades, however, made money "by moving electricity around in a circle" from A to B right back to A. *See* Staff Report at 30-32 and 47-50. There can be no price spread between a path and itself.

9 Attachment B-1.

10 Attachment B-1.

> *same price and making money entirely from the . . . payback of marginal losses, then that's not.* I mean, I'm not, and again, I want to be clear. I want to be clear, I'm not, you're not violating the rules. In our view though it's not consistent with the spirit of the rules.[11]

Thus, to the extent that Bowring's statements about this other strategy are relevant to Movants' trading, his comments are inculpatory and consistent with the Staff Report, which contends that Movants' trades did not reflect economic fundamentals and were an example of "gaming the rules" despite not violating any specific provision of PJM's tariff.[12]

Movants' theory is that Bowring's non-referral of the SOUTHIMP/SOUTHEXP trading strategy as of July 27, 2010 demonstrates that he must, as of that day, have deemed that strategy not to be manipulative because the IMM is obligated by PJM's Tariff "to 'immediately' inform Enforcement if he has identified a 'potential Market Violation.'"[13] Movants are wrong: In fact, Bowring did immediately inform Enforcement of his concerns. He first expressed those concerns to Enforcement staff on July 28, 2010 – *the day after* his conversation about the SOUTHIMP/SOUTHEXP strategy – and continued to do so in a series of conversations over the following days and weeks.[14] Bowring contacted Chen on August 2, 2010. On August 5, 2010, the IMM made a presentation to the PJM Markets and Reliability Committee in which it discussed improper UTC trading and its impacts on the market. The same topic was discussed at the August 12, 2010 PJM Members' Committee meeting, where the IMM proposed a revision to the PJM tariff to address the abusive UTC trading. PJM made a written

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11 Attachment B-1 (emphasis supplied).

12 *See* Staff Report at 18-19, 38-39, 47-50.

13 Motion at 2, citing PJM OATT Attachment M, Section IV.I.1.

14 The IMM may provide the required notification "either orally or in writing." PJM OATT Attachment M, Section IV.I.1.

referral to Enforcement on August 16, 2010,[15] and Enforcement promptly opened its investigation. PJM filed its proposed tariff revisions on August 18, 2010 and the Commission made Enforcement's investigation formal on August 25, 2010. There is no room in this chronology for the vacillation Movants attribute to the IMM.[16] The IMM, PJM, and the Commission all expressed concern about this behavior being harmful and potentially manipulative and all worked with alacrity to address it – and none of them ever alleged that it was a tariff violation.[17]

Moreover, nothing can be inferred from Bowring's declining to state that he had referred the conduct. As he explained in a further conversation with Unnamed Company on August 6, 2010, "I can't tell you whether I referred you to FERC or not because those are by definition confidential."[18] Even if the July 27, 2010 conversation had been about Chen's "sending electricity in a circle" round trip trades, Movants' inference would still be wrong.

2. Similar Audio Recordings Are Also Not Exculpatory

Although not obligated to do so, in light of the Motion, Enforcement staff has re-reviewed all of the audio recordings gathered in the investigation of Unnamed Company. We are submitting them non-publicly with this Answer, along with unofficial transcripts of the two calls discussed herein.[19]

These recordings are all similarly irrelevant to Movants' culpability or liability: None of the traders who participated in the taped conversations engaged in round trip

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15 Attachment A. The PJM referral has been redacted to exclude entities and trading schemes not at issue in this proceeding.

16 This chronology is discussed in greater detail in the Staff Report at 29 – 34.

17 *See also*, Attachment C (IMM Referral). As with the PJM Referral, this document has been redacted.

18 Attachment B-2.

19 Attachments B-1 and B-2 are the unofficial transcriptions; Non-Public Attachment B-3 is a CD containing audio files of all of the conversations.

trades like those discussed in the Staff Report — that is, simultaneous transactions in opposite directions between the same two points. In fact, when round trip trades like Respondents' did come up, Unnamed Company stated (and the IMM agreed) that such trades were abusive and harmful to the market.

In a call dated August 6, 2010, counsel for Unnamed Company suggested that Unnamed Company, along with other of her clients, had seen "transactions going on *which they too thought were abusive*. I mean they don't want abusive transactions going on either . . . Because it just harms the sector."[20] When asked by Bowring to identify "abusive transactions," Unnamed Trader explained:

> I mean the trades specifically . . . that we think are inappropriate are the ones that don't have any price delta. . . . The other transactions that we don't agree are appropriate are the ones that, you know, import and export from the same point. So, if you had points sinking at a COOK and sourcing at a COOK and going to the same interface, you know, we agree completely, you know, that's, *you could term that a wash trade*.[21]

In other words, Unnamed Trader expressed his agreement with Bowring that that wash UTC trades like Movants'[22] are abusive and inappropriate and "just harm[] the sector."[23] That is, the recording is inculpatory, not exculpatory.

The Commission has voluntarily adopted a policy of disclosing exculpatory evidence material to liability and penalties. The point of that policy "is not to supply a defendant with all the evidence in the Government's possession which might conceivably

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20 *See* Attachment B-2 (emphasis added).

21 *Id.* (emphasis added).

22 COOK was one of the principal points Chen used in his manipulative round trip trades. *See* Staff Report at 55, n.292. Movants admit that they intentionally executed trades with no "price delta." *See generally* Staff Report at 24-29, especially at 25 citing K. Gates Test. Vol. II Tr. 178:12-15 (acknowledging that he knew Chen was "very clearly trying to eliminate" the congestion spread) and K. Gates Test. Vol. II Tr. 172:3-9 (acknowledging that he knew that Chen "was trying to drive . . . the day-ahead versus real-time [i.e., the "delta"] to zero").

23 Attachment B-2.

assist in the preparation of his defense, but to assure that the defendant will not be denied access to *exculpatory* evidence known only to the Government."[24]

The voice recordings from the Unnamed Company investigation are not exculpatory in any sense. They pertain to a different trading strategy by a different entity, and to opinions expressed about that different trading strategy by PJM's IMM and other market participants. At best for Respondents, they include a statement of opinion by the IMM about a matter not in dispute here, namely that the trades did not violate the tariff. Moreover, "*Brady* applies only to evidentiary material *other than opinions.*"[25] To the extent Movants' trading strategy is discussed, it is rightly condemned as abusive and harmful.

B. The PJM Data

In addition to the voice recordings discussed above, Movants cite a notice PJM provided to its members indicating that PJM had provided Enforcement staff with a simulated reallocation of MLSA to other market participants with certain transactions removed.[26] The Motion concedes that "[w]ithout seeing the material, it is difficult for us to say whether it falls within the four corners of the Commission's *Brady* Policy."[27] It plainly does not.

The Staff Report identifies both the amount of harm to the market and the amount of unjust profits to Movants attributable to the transactions at issue in this proceeding.

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24 *Policy Statement on Disclosure of Exculpatory Materials,* 129 FERC ¶ 61,248 at P 3 (emphasis added), *quoting United States v. LeRoy,* 687 F.2d 610, 619 (2d Cir. 1983).

25 *Policy Statement on Disclosure of Exculpatory Materials,* 129 FERC ¶ 61,248 at P 14 (emphasis added).

26 In voicemails left by counsel for Chen with Enforcement staff on January 23, 2015, the only issue he raised was whether the data mentioned in the PJM notice pertained to his client. He expressed no urgency, made no reference to *Brady*, to voice recordings, or to a proposed extension of time, and did not even express a desire to receive the data.

27 Motion at 4.

The PJM data sought by staff in January merely shows how much individual market participants lost because of Respondents' manipulative trades. The material is not in any way exculpatory.

Staff had originally intended to produce this material directly to Movants five days after staff received it. (The five-day period was intended as a courtesy to PJM, to allow it to comply with its Rules calling for five days' notice to its affected members.) In the interest of transparency, however, to establish beyond doubt that this material is not exculpatory, and because, as Movants state, "it seems efficient to deal with it at the same time" as the voice recordings,[28] staff is attaching the PJM data to this Answer.[29]

What the PJM data show is that harm from Movants' trading was both widely distributed throughout PJM and significantly concentrated on certain load-serving entities. In fact, while hundreds of market participants were affected in some way, more than 20 market participants were deprived by Movants' round-trip UTC trades of more than $100,000 each and four lost more than $500,000 each, including PECO Energy Company ($569,976), Commonwealth Edison Company ($656,933), Dominion Virginia Power (LSE) ($1,147,087) and Appalachian Power Company (AEP Generation) ($1,450,972).[30]

The market harm numbers in the PJM data differ slightly from the market harm numbers in the Staff Report. While the Staff Report estimates total market harm to have been $10,158,313, the PJM analysis estimates market harm to have been $10,046,808 – a

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28 Motion at 4.

29 Attachment D, *and see*, Order to Show Cause at P 5 ("The Commission authorizes OE staff to disclose information obtained during the course of this investigation as necessary to advance this matter.").

30 *See* Attachment D. Staff has not attempted to ascertain the aggregate losses suffered by affiliated companies (e.g., by affiliates of Exelon or by members of American Municipal Power) but based on a cursory review of the data, it appears that these were in some cases significant.

difference of $111,505, or approximately 1%. Although Enforcement Staff has not audited PJM's analysis, it believes that the *de minimis* difference is readily explained: in performing its analysis, PJM treated each of the funds for which Chen traded – HEEP, Powhatan, and CU Fund – as separate. In other words, in analyzing the harm to the market from, e.g., HEEP's trades, PJM's analysis treated Powhatan as if it were another victim of those trades. But since Powhatan, HEEP, and CU Fund executed the same trades (indeed, HEEP and Powhatan were contractually obligated to do so), such an analysis understates the magnitude of overall harm to the market.[31] In any event, the information is not in any way exculpatory.

C. No Prejudice

Although they are not exculpatory, Movants now have the materials they have requested and do not need additional time to file their Answer.[32] Nevertheless, provided that the deadline for their Answer (for which Respondents have already gotten a 15-day extension) is not changed, Enforcement staff does not oppose granting Respondents the opportunity to make a supplemental submission, limited to addressing the materials filed with this Answer, no later than February 9, 2015.

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31 Investigations of UTC trading by other market participants are ongoing. *See*, *e.g.*, *City Power Marketing, LLC and K. Stephen Tsingas*, Staff Notice of Alleged Violations (Aug. 25, 2014). Excluding manipulative transactions by other market participants from receipt of MLSA disgorged from Respondents would further increase the dollar impact on legitimate market participants.

32 As discussed in the Staff Report, Powhatan sought (and Enforcement agreed to) a 25-day extension of time, ostensibly to prepare their answer to the Preliminary Findings Letter. On the extended deadline date (after 55 days), Powhatan submitted a two-sentence response to staff's Preliminary Findings. *See* Staff Report at 35 & n.198. Movants have now, without explanation, twice rejected Enforcement staff's offer to support their requested extensions in exchange for a simple day-for-day tolling agreement.

II. Conclusion

For the reasons discussed above, Enforcement Litigation staff respectfully requests that Movants' request be denied.

Respectfully submitted,

/s/

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Dated: January 29, 2015

CERTIFICATE OF SERVICE

I hereby certify that on this day a copy of the foregoing Answer has been served upon counsel for Movants in the above-referenced proceeding.

Dated at Washington, D.C., on this 29th day of January, 2015.

/s/

____

Samuel G. Backfield
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Attachment B-1

Unofficial Transcription of July 27, 2010 Voice Recording

PUBLIC VERSION

CONFIDENTIAL INFORMATION REDACTED

Transcript of Audio Recording: [redacted]
Date of Audio Recording: July 27, 2010
Date of Transcript: January 27, 2015
Call Participants: [redacted]; Joe Bowring (hereafter "JB") and John Dadorian (JD), PJM Internal Market Monitor (PJM IMM).

JB: Bowring.

[redacted] Hi Joe. This is [redacted]. Good afternoon.

JB: Hey. Yeah, how are you? We were just about to call you.

[redacted] Yeah, good.

JB: Hang on, I'm just putting you on speaker. Can you hear me?

[redacted] Yeah sure.

JB: That's great. So, I have, I have John Dadourian here with me.

[redacted] Hi John.

JD: Hey [redacted]

[redacted] It's not a good sign that I have your phone number to memory, Joe.

[Chuckle by unknown individual.]

JB: Yeah, yeah. Well, you've called it a lot lately. So, our, our concern is that, it appears to us that, that these transactions are really just designed to, to, arbitrage the difference between transmission rates and, the, marginal losses compensation, and that's not really a legitimate reason to engage in the transaction. Am I missing something here?

[redacted] I would say that, that the trades on their own do have a potential for profit.

JB: Right, so right, right. Exactly. So, but, so we think that, we think that's an example of gaming the, gaming the rules and that's not a, not a reason consistent with the underlying reason the market is structured the way it is and I, I understand that it is a profit opportunity, but we think it is a, a, a non-legitimate one. So we wanted to tell you that, see what your reaction was and then, and obviously we have, we can't make you stop, but if you choose not to stop, then, you know, our next recourse is to talk to FERC about it.

[redacted] Uh huh.

JB: And ultimately, and ultimately, to try to get the, the rule, the rule changed because, I mean, it's incenting this behavior which is designed to make money from the fact that we have this weird discontinuity in the rules and I understand why, why your traders would be doing it, but I think you can also understand why we don't think it, it represents anything about the economic fundamentals.

[redacted] Well I guess the question I have then is that, where you draw the line for, you know, what would be done for that purpose versus, you know, what, what you would consider legitimate economic value. Because we do.

JB: Yeah, you know.

[redacted] We do consider it legitimate economic value.

JB: Sure, you know, I think the line is pretty easy to draw and that is, if there, if engaging in the transaction itself results in a profit because you're buying it for less than you're selling it for, that's legitimate. If you're, the only reason you're making money from the transaction is because you're buying and selling at the same price and making money entirely from the, the, the payback of the marginal losses, then that's not. I mean, I'm not, and again, I want to be clear, I want to be clear, I'm not, you're not violating the rules. In our view though, it's not consistent with the spirit of the rules.

[redacted] You know to be honest with you, I don't know that we are buying the same price and selling the same price for any transaction other than the SOUTHIMP/SOUTHEXP, and up until yesterday…

JB: [Inaudible]

[redacted] Go ahead.

JB: No, I was just going to say those are the ones we are talking about.

[redacted] Ok, well, up until yesterday I didn't realize, we didn't realize that those are actually the same pricing points. That was completely news to us. By, if you look at, uh, if you look at the history, the pricing history, those, there are many occasions where, where those things have diverged on Dominion-type constraints. And you know, John and I went through, through an exercise yesterday where it was, it was completely evident to us that they were two completely different pricing points, but John made me aware that that is not the case. So with that transaction, we are not doing that transaction any longer.

JB: Ok. I think that was the primary.

[redacted] Now.

[redacted] I'm sorry.

JB: Go ahead. No, I think that was the primary, that is the primary one we were concerned about.

[redacted] Ok well, we had that transaction out there for today. John and I spoke yesterday morning. We had already purchased and submitted the transaction. So that was out for today, but today, for tomorrow's market, we have not done it and we will not do it again.

JB: Ok. That sounds fine. That, that was the one we were worried about. Because, I mean, if your, if there is additional money to be made from that, from that, from the result of the marginal losses on top of what's otherwise a transaction then we don't have an issue. I mean, I don't like the rule, but that's not, that's not the point. Here, here, the only problem is coming from that, from the difference between that rate, and the transmission rate.

[redacted] Right. Well yeah, if you look at the pricing history again, you know the SOUTHIMP/SOUTHEXP, there are a number of times where they have diverged in, in pricing and, you know, I became aware that, that really wasn't because the, the market, you know, model dictated it. Apparently, it was because of an error, you know, someone not putting a transmission line back into the model, or yeah, I don't know what it was exactly, but, so.

JB: Yeah.

[redacted] So, that we are aware of and, and it will not happen again with this company.

JB: Good, alright. Well, that sounds great. I just wanted to check in on that. So, and so, we're not, we're not going to take any further action on this. I mean another thing we are probably going to do is probably bring something into the membership process, if not directly to FERC, not about you, but just about the rule, the rule, about the market losses generally so, so.

[redacted] Ok.

JB: We're good. I appreciate the call back.

[redacted] Ok. Well, thank you for your patience in uh, in connecting here.

JB: Yep. No problem. Thanks a lot.

[redacted] Ok. Thanks Joe. Bye John.

JB: Yep, Bye.

JD: Bye-Bye.