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

FEDERAL ENERGY REGULATORY COMMISSION Plaintiff, v. POWHATAN ENERGY FUND LLC, HOULIAN "ALAN" CHEN, HEEP FUND, INC., and CU FUND, INC. Defendants.	:	CIVIL ACTION NO. 3:15-CV-00452-MHL

POWHATAN ENERGY FUND'S MOTION TO DISMISS THE COMPLAINT

Defendant Powhatan Energy Fund LLC hereby moves, pursuant to Federal Rule of Civil Procedure 12(b)(6), to dismiss the complaint in the above-captioned matter with prejudice. Arguments in support of this motion are set forth in the accompanying memorandum.

Dated: October 19, 2015.

/s/ John Staige Davis, V

John Staige Davis, V
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, VA 23219
(804) 420-6000

William M. McSwain (admitted *pro hac vice*)
Christian E. Piccolo (admitted *pro hac vice*)
DRINKER BIDDLE & REATH LLP
One Logan Square, Suite 2000
Philadelphia, PA 19103-6996
(215) 988-2700

Attorneys for Powhatan Energy Fund LLC

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FOR THE EASTERN DISTRICT OF VIRGINIA
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FEDERAL ENERGY REGULATORY COMMISSION	:	
	:	
Plaintiff,	:	
	:	
v.	:	CIVIL ACTION
	:	NO. 3:15-CV-00452-MHL
POWHATAN ENERGY FUND LLC, HOULIAN "ALAN" CHEN, HEEP FUND, INC., and CU FUND, INC.	:	
	:	
Defendants.	:	

MEMORANDUM IN SUPPORT OF
POWHATAN ENERGY FUND'S MOTION TO DISMISS THE COMPLAINT

John Staige Davis, V
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, VA 23219
(804) 420-6000

William M. McSwain (admitted *pro hac vice*)
Christian E. Piccolo (admitted *pro hac vice*)
DRINKER BIDDLE & REATH LLP
One Logan Square, Suite 2000
Philadelphia, PA 19103-6996
(215) 988-2700

Attorneys for Powhatan Energy Fund LLC

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTRODUCTION 1

STATEMENT OF FACTS 2

SUMMARY OF ARGUMENT 4

ARGUMENT 5

I. THE COMPLAINT SHOULD BE DISMISSED BECAUSE POWHATAN NEVER RECEIVED FAIR NOTICE THAT FERC WOULD CONSIDER THE TRADES AT ISSUE TO BE UNLAWFUL 6

A. The Relevant Commission Orders *Actually Predicted* That UTC Traders Would Pursue Trades That Were Profitable Only After Including The Rebates And Never Stated That There Were Legal Problems With Such Trading 7

B. The Relevant Due Process/Fair Notice Case Law Is Overwhelmingly In Powhatan's Favor 15

1. The Complaint Should Be Dismissed Based On The Binding "Fair Notice" Precedent Of *United States v. Hoechst Celanese Corporation* And *First American Bank Of Virginia v. Dole* In The U.S. Court Of Appeals For The Fourth Circuit 15

2. The Fair Notice Case Law In Other Jurisdictions Also Dictates That The Complaint Should Be Dismissed 20

C. Reliance On The General Language Of The Anti-Manipulation Rule Cannot Save FERC Here Because Specific Regulatory Pronouncements Trump General Ones 27

CONCLUSION 30

TABLE OF AUTHORITIES

Page(s)

CASES

Ashcroft v. Iqbal,
566 U.S. 662 (2009)....................6

Bloate v. United States,
599 U.S. 196 (2010)....................28

Bonneville Power Admin. v. F.E.R.C.,
422 F.3d 908 (9th Cir. 2005)....................29

Bulova Watch Co. v. United States,
365 U.S. 753 (1961)....................29

Clifford F. MacEvoy Co. v. United States,
322 U.S. 102 (1944)....................29

Covenant Med. Ctr., Inc. v. Sebelius,
424 F. App'x 434 (6th Cir. 2011)....................28

Diamond Roofing Co. v. OSHRC,
528 F.2d 645 (5th Cir. 1976)....................16, 26

E. Shore Mkts., Inc. v. J.D. Assocs. L.P.,
213 F.3d 175 (4th Cir. 2000)....................6

Escondido Mut. Water Co. v. F.E.R.C.,
692 F.2d 1223 (9th Cir. 1982), *rev'd in part on other grounds* 467 U.S. 1267 (1984)..........29

Fabi Constr. Co. v. Sec'y of Labor,
508 F.3d 1077 (D.C. Cir. 2007).................... 25-26

FCC v. Fox Television Stations, Inc.,
556 U.S. 502 (2009)....................25

FCC v. Fox Television Stations, Inc.,
__U.S. __, 132 S. Ct. 2307 (2012)....................6, 25

First Am. Bank of Va. v. Dole,
763 F.2d 644 (4th Cir. 1985).................... *passim*

Fourco Glass Co. v. Transmirra Prods. Corp.,
353 U.S. 222 (1957)....................29

Francis v. Giacomelli,
588 F.3d 186 (4th Cir. 2009) 6

Gen. Elec. Co. v. EPA,
53 F.3d 1324 (D.C. Cir. 1995) 26

Glavin v. Clinton,
19 F. Supp. 2d 543 (E.D. Va. 1998) 29

Gordon v. Greenpoint Credit,
266 F. Supp. 2d 1007 (S.D. Iowa 2003) 29

Grayned v. City of Rockford,
408 U.S. 104 (1972)...6

Jeffrey v. Trans Union LLC,
273 F. Supp. 2d 725 (E.D. Va. 2003) 29

KPMG, LLP v. SEC,
289 F.3d 109 (D.C. Cir. 2002) 22-23

Long Island Care at Home, Ltd. v. Coke,
551 U.S. 158 (2007)...28

In re Metro-E. Mfg. Co.,
655 F.2d 805 (7th Cir. 1981) 19

Miles v. Phenix City Hous. Auth.,
No. 3:11-CV-216-WKW, 2011 WL 2580390 (M.D. Ala. June 29, 2011) 28

Morton v. Mancari,
417 U.S. 535 (1974)...29

Peterson v. ConAgra Foods, Inc.,
No. 13-cv-3158-L (NLS), 2014 WL 3741853 (S.D. Cal. July 29, 2014) 26

Philips v. Pitt Cnty. Mem'l Hosp.,
572 F.3d 176 (4th Cir. 2009) 4

Radio Athens, Inc. v. FCC,
401 F.2d 398 (D.C. Cir. 1968) 26

Satellite Broad. Co. v. FCC,
824 F.2d 1 (D.C. Cir. 1987) 26

SEC v. Pentagon Capital Mgmt.,
844 F. Supp. 2d 377 (S.D.N.Y. 2012), *vacated in part on other grounds*, 725 F.3d 279 (2d Cir. 2013)....23-25

Sec'y of Labor v. Carborundum Co., Electro Mineral Div.,
OSHRC Docket No. 79-860, 1982 WL 189097 (Occupational Safety Health Review Comm'n Sept. 29, 1982)....28

Smith v. Goguen,
415 U.S. 566 (1974)....6-7

Spreckels v. Helvering,
315 U.S. 626 (1942)....28

Tasker v. DHL Ret. Sav. Plan,
621 F.3d 34 (1st Cir. 2010)....28

Title Redacted by Agency,
No. 08-12 904, 2015 WL 3529208 (Bd. Vet. App. Apr. 21, 2015)....28

Trinity Broad. of Fla., Inc. v. FCC,
211 F.3d 618 (D.C. Cir. 2000)....26

Ubl v. Kachouroff,
937 F. Supp. 2d 765 (E.D. Va. 2013)....6

United States v. AMC Entm't, Inc.,
549 F.3d 760 (9th Cir. 2008)....25

United States v. Estate of Romani,
523 U.S. 517 (1998)....29

United States v. Hoechst Celanese Corp.,
128 F.3d 216 (4th Cir. 1997)....*passim*

United States v. Williams,
553 U.S. 285 (2008)....6

Upton v. SEC,
75 F.3d 92 (2d Cir. 1996)....20-22

Regulatory Authorities

Black Oak Energy, LLC v. PJM Interconnection, LLC,
Order Denying Complaint, 122 F.E.R.C. ¶ 61,208 (Mar. 6, 2008)....9-10

Black Oak Energy, LLC v. PJM Interconnection, LLC,
Order Denying Reh'g in Part & Granting Reh'g in Part, 125 F.E.R.C. ¶ 61,042 (Oct. 16, 2008) 9-10

Black Oak Energy, LLC v. PJM Interconnection, LLC,
Order Accepting Compliance Filing, 128 F.E.R.C. ¶ 61,262 (Sept. 17, 2009) 9-10

Cal. Indep. Sys. Operator Corp.,
132 F.E.R.C. ¶ 61,045 (July 15, 2010) 13

Cal. Indep. Sys. Operator Corp.,
134 F.E.R.C. ¶ 61,211 (Mar. 17, 2011) 13

Midwest Indep. Transmission Sys. Operator, Inc.,
108 F.E.R.C. ¶ 61,236 (Sept. 16, 2004) 12-13

Midwest Indep. Transmission Sys. Operator, Inc.,
114 F.E.R.C. ¶ 61,106 (Feb. 3, 2006) 13

Midwest Indep. Transmission Sys. Operator, Inc.,
137 F.E.R.C. ¶ 61,213 (Dec. 15, 2011) 13

PJM Interconnection, L.L.C.,
122 F.E.R.C. ¶ 61,082 (Jan. 31, 2008) 13

Prohibition of Energy Mkt. Manipulation,
114 F.E.R.C. ¶ 61,047 (Jan. 19, 2006) 11

Sw. Power Pool, Inc.,
144 F.E.R.C. ¶ 61,255 (Sept. 30, 2013) 13

OTHER AUTHORITIES

PJM Open Access Transmission Tariff § 5.5 (Third Revised Sheet No. 399C) 7

INTRODUCTION

Powhatan Energy Fund LLC ("Powhatan") has been patiently waiting for this opportunity for over five years – the day that its arguments will finally be heard by a neutral decision-maker. At its core, this case is very simple: it boils down to whether it is permissible for an energy trader to take into account monetary "credits" or "rebates" that he receives for placing certain trades when deciding whether to make those trades in the first place. As a matter of common sense, the answer is "yes" – or, more accurately, "of course." It is a fact of life that traders make trades in order to make money. As long as they are following the rules of their trading market, they do not (and never have and never will) differentiate between different sources of money – all money is green, and all money is part of the pricing signal that an energy trader (or any other type of trader) pays attention to when deciding whether to place a trade. If a trader gets paid for predicting energy prices, he will care about the movement of energy prices, which in turn influences his decision whether to make a particular trade. And if a trader gets paid in the form of a credit or rebate for placing a trade, he will also care about the credit or rebate, which likewise influences his decision whether to make a particular trade. This is elementary stuff that is second nature to traders.

But the Federal Energy Regulatory Commission ("FERC" or "the Commission") wants to make it artificially complicated. It wants to pretend that not all money is green. It wants to pretend that there are, say, green dollars and purple dollars. It wants to pretend that energy traders have a responsibility to pursue only certain colors of money – maybe the green dollars are OK, but not the purple ones. And why are the purple dollars forbidden? Not for any defensible reason – but simply because FERC says so *after* the trading at issue has already occurred, which raises obvious constitutional due process/fair notice problems that are the subject of this motion

to dismiss the complaint. This unfair, capricious and unconstitutional regulatory approach has left Powhatan and its principals completely bewildered.

Powhatan and its principals have never, ever believed that they have done anything wrong – let alone anything illegal or fraudulent. They have nothing to hide about the trades at issue and have always wanted FERC's investigation to be exposed to the light of day. This is what motivated them, for example, to create a public website, ferclitigation.com, devoted to transparency about the investigation. Now all they seek is an unbiased evaluation of their arguments. After enduring over five years of frustration and immense costs defending itself against FERC's heavy-handed and unnecessarily drawn-out investigation, Powhatan brings this motion to dismiss the complaint.

STATEMENT OF FACTS

For purposes of this motion, the relevant allegations are straightforward. The complaint alleges that certain trades made by defendant Dr. Houlian "Alan" Chen in the PJM Interconnection ("PJM") market between June 1 and August 3, 2010 were fraudulent because the trades were designed to capture the marginal loss surplus allocation ("MLSA") that was paid to traders in one of PJM's virtual products, called Up-To Congestion ("UTC") transactions. Compl. ¶¶ 14-15. (The MLSA is also referred to interchangeably as "transmission loss credits" ("TLCs"), "loss credits," "credits" or "rebates"). More specifically, FERC alleges that Dr. Chen and Powhatan are guilty of market manipulation because Dr. Chen's trades violated section 222 of the Federal Power Act ("FPA"),[1] which was implemented by the Commission via its anti-

[1] This section makes it "unlawful for any entity . . . directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy . . . any manipulative or deceptive device or contrivance . . . ." Compl. ¶ 30.

manipulation rule.[2] Compl. ¶¶ 30-31.

Dr. Chen was a virtual trader, in that his UTC trades did not result in the physical delivery of power. *Id.* ¶¶ 37-39. He made some of his trades on behalf of Powhatan, with which he had a contractual relationship. *Id.* ¶ 73.

Dr. Chen had to pay transmission costs for each individual trade before placing the trade (sometimes referred to as reserving transmission). *Id.* ¶¶ 44-45. PJM would collect these transmission costs, which ultimately resulted in surplus revenue (the MLSA) that PJM would then refund to the traders. *Id.* ¶¶ 44-45, 66. The MLSA was paid automatically to UTC traders "in proportion to the volume of [megawatts] of paid-for transmission that they had reserved in connection with their trades." *Id.* ¶ 45.

The complaint alleges that Dr. Chen's supposedly fraudulent trading was designed solely to collect the MLSA. *Id.* ¶¶ 15, 75, 88.[3] He put on trades that "were certain themselves to lose money" absent the MLSA, and he increased the volume of his trades. *Id.* ¶¶ 68-69, 88. Without the ability to collect the rebates, Dr. Chen would not have pursued such trades. *Id.* ¶ 5. FERC describes such trading as "uneconomic." Order Assessing Civil Penalties ("Order") ¶¶ 61, 76-

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[2] This rule "prohibits any entity from: (1) (a) using a fraudulent device, scheme, or artifice, or (b) making a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule, or regulation, or (c) engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity, (2) with the requisite scienter, (3) in connection with the purchase or sale of electricity subject to the jurisdiction of the Commission." Compl. ¶ 31.

[3] In reality, Dr. Chen' trades in question were motivated only *in part* by collection of the MLSA: he was not just going after the "purple dollars" associated with the rebates, but instead was attuned to all possible ways to make money on the trades, including via possible windfall profits associated with one "leg" of a paired trade being rejected. But for purposes of this motion to dismiss, we must accept the complaint's allegations as true and assume for now that Dr. Chen was pursuing only the "purple dollars" associated with the rebates.

77, 84, attached to the complaint as Exhibit 1.[4] The alleged harm from such trading was that Dr. Chen (and Powhatan) got a bigger piece of the MLSA pie than they otherwise would have gotten, thereby depriving others of some of the pie. Compl. ¶¶ 20, 79, 89.

On August 2, 2010, the Independent Market Monitor ("IMM") for PJM, Joseph Bowring, telephoned Dr. Chen to express concern about his trading; as a result, Dr. Chen ceased making trades that considered the rebates. Enforcement Staff Report and Recommendation ("Report") at 30, attached to the complaint as Appendix A to Exhibit 2. Soon thereafter, PJM proposed changes to the relevant tariff that ended a trader's "obligation to reserve paid-for transmission for UTCs," thereby eliminating the MLSA payments and the corresponding "financial incentives to trade in this manner." *Id.* at 32. FERC approved the proposed tariff change on September 17, 2010. *Id.*

SUMMARY OF ARGUMENT

The complaint should be dismissed because what FERC seeks to do here is unconstitutional. Powhatan did not have fair notice that FERC would try to penalize it for trading that was motivated by the collection of the MLSA. The relevant Commission orders in the earlier *Black Oak* proceeding actually predicted that UTC traders would pursue trades that were profitable only after including the rebates and never stated that there were legal problems with such trading.

Binding Fourth Circuit precedent in *United States v. Hoechst Celanese Corp.*, 128 F.3d

[4] 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).

216 (4th Cir. 1997), and *First American Bank of Virginia v. Dole*, 763 F.2d 644 (4th Cir. 1985), dictates that the complaint should be dismissed because Powhatan and Dr. Chen had "reason to believe" that the trading was legal – and because a finding of liability would "retroactively" impose a duty on them that did not exist in the summer of 2010. *Hoechst Celanese*, 128 F.3d at 226; *First Am.*, 763 F.2d at 652. Powhatan was entitled to "clear notice" of any duty it supposedly had not to pursue the rebates. *First Am.*, 763 F.2d at 651 n.6. It never received such notice. And to the extent that there was any ambiguity in the governing standards, it is not Powhatan that must suffer the consequences. Rather, "[t]he responsibility to promulgate clear and unambiguous standards is upon the administrative agency alone." *Id.* at 652 n.7.

On this issue of fair notice, Powhatan has an overwhelming amount of judicial authority in its corner – not just in the Fourth Circuit, but throughout the country. FERC's only hope in opposing the instant motion is to try to convince the Court that Powhatan had fair notice all along because of the existence of the general anti-manipulation rule, which FERC will argue prohibited the trading at issue. There are several reasons why FERC is wrong about that, but the most basic one is this: it is black letter law that a specific regulatory pronouncement trumps a general one. What matters, then, when assessing the notice that Powhatan received is what FERC had to say about *the specific trading at issue*, which is found in the *Black Oak* orders. General pronouncements against "fraud" or "deceit" in the anti-manipulation rule are simply irrelevant. Accordingly, it is plain that Powhatan did *not* receive fair notice here.

ARGUMENT

The legal standard for evaluating a motion to dismiss a complaint is well-settled. The Court may grant a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) where the complaint "does not state a claim upon which relief can be granted." *Francis v. Giacomelli*, 588 F.3d 186,

192-93 (4th Cir. 2009). "Judgment should be entered when the pleadings, construing the facts in the light most favorable to the non-moving party, fail to state any cognizable claim for relief, and the matter can, therefore, be decided as a matter of law." *Ubl v. Kachouroff*, 937 F. Supp. 2d 765, 768 (E.D. Va. 2013) (internal quotation marks and citation omitted). To survive a motion to dismiss, the complaint "must contain more than labels and conclusions, and a formulaic recitation of the elements of a cause of action." *Giacomelli*, 588 F.3d at 193 (internal quotation marks and citations omitted). In evaluating a motion to dismiss, the Court must accept the factual matter in the complaint as true. *Id.* (citing *Ashcroft v. Iqbal*, 566 U.S. 662, 678 (2009)). However, the Court "need not accept the legal conclusions drawn from the facts" or "accept as true unwarranted inferences, unreasonable conclusions, or arguments." *E. Shore Mkts., Inc. v. J.D. Assocs. L.P.*, 213 F.3d 175, 180 (4th Cir. 2000).

I. THE COMPLAINT SHOULD BE DISMISSED BECAUSE POWHATAN NEVER RECEIVED FAIR NOTICE THAT FERC WOULD CONSIDER THE TRADES AT ISSUE TO BE UNLAWFUL.

Due process requires that "laws 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); *see also FCC v. Fox Television Stations, Inc.*, __U.S. __, 132 S. Ct. 2307, 2318 (2012) (holding that "[t]he Commission's lack of notice to Fox and ABC that its interpretation had changed so the fleeting moments of indecency contained in their broadcasts were a violation of § 1464 as interpreted and enforced by the agency 'fail[ed] to provide a person of ordinary intelligence fair notice of what is prohibited.'" (quoting *United States v. Williams*, 553 U.S. 285, 304 (2008))). Due process "incorporates notions of fair notice or warning" and "requires legislatures to set reasonably clear guidelines for law enforcement officials and triers of fact in order to prevent 'arbitrary and discriminatory enforcement.'" *Smith v. Goguen*, 415 U.S. 566,

572-73 (1974) (citations omitted).

As explained in detail below, this case is tailor-made for a motion to dismiss. FERC has alleged no facts that would have given Powhatan or Dr. Chen fair notice, either prior to or during the relevant period at issue, that Dr. Chen's trades were prohibited. The fair notice standard is an objective one – based on what a person of "ordinary intelligence" would have concluded about the relevant FERC orders and regulations that existed at the time of the trading in question. The complaint should be dismissed as a matter of law.

A. The Relevant Commission Orders *Actually Predicted* That UTC Traders Would Pursue Trades That Were Profitable Only After Including The Rebates And Never Stated That There Were Legal Problems With Such Trading.

No PJM tariff provision or Commission order ever alerted Powhatan that FERC would consider the trading at issue unlawful. Moreover, the tariff language relating to the rebates expressly provided for them to be paid to anyone who incurred the transmission costs and other fixed costs of the PJM system, without any other limitation. *See* PJM Open Access Transmission Tariff § 5.5 (Third Revised Sheet No. 399C). Because those rebates were distributed *automatically* to all purchasers of transmission in PJM, the rebates were part of the overall pricing incentive for Dr. Chen (and other traders) to consider when making UTC trades.

Responding rationally to that pricing incentive, Dr. Chen (with Powhatan's support) made trades in the summer of 2010 that took the rebates fully into account. He put on trades that he otherwise would not have made, absent the rebates. And he made money on most (but certainly not all) of those trades, once the rebates were included. In other words, Dr. Chen did not make a distinction between green dollars and purple dollars when making his trades – to him and to Powhatan, dollars are dollars. Dr. Chen pursued the "purple dollars" associated with the

MLSA simply because they were available and therefore part of the overall financial picture of the trade. When he saw an opportunity to make money in the summer of 2010, he naturally wanted to make as much as he could, within the bounds of the existing PJM tariff and Commission orders. Arguably, he even had a fiduciary duty to Powhatan to try to maximize the possible profits he could make from the rebates.

Dr. Chen did not attempt to hide, conceal or misrepresent anything to PJM or to other market participants. For all of his trades, he accurately entered the information into the OASIS system that was necessary to conduct the trades. His trades were carried out openly. He did not make false or misleading representations. Even the FERC Enforcement Staff recognizes this. *See* Report at 50 (admitting that the trades "did not involve any false statements, active concealment, or other explicit tariff violations").

Most importantly for purposes of the instant motion, Dr. Chen's trading occurred against the backdrop of prior Commission pronouncements about the *exact* issue at the heart of this case – namely, whether it was permissible for UTC traders to pursue the MLSA in the summer of 2010. Prior to that time, PJM's mechanism for distributing the MLSA had been extensively litigated in the *Black Oak* proceeding. When it first addressed the allocation of the MLSA in that proceeding, the Commission explicitly recognized the incentives that the credits would provide to virtual traders:

> Paying excess loss charges to arbitrageurs also is inconsistent with the concept of arbitrage itself. The benefits of arbitrage are supposed to result from trading acumen in being able to spot divergences between markets. As stated above, arbitrageurs create their own load by the volume of their trades. ***If arbitrageurs can profit from the volume of their trades, they are not reacting only to perceived price differentials in LMP or congestion, and may make trades that would not be profitable based solely on price differentials alone.***

Black Oak Energy, LLC v. PJM Interconnection, LLC, Order Denying Complaint, 122 F.E.R.C. ¶ 61,208 at P 51 (Mar. 6, 2008) (emphasis added). The Commission addressed the very same issue about including virtual traders in the allocation of loss credits when it considered Black Oak Energy's request for rehearing of the Commission's order denying the complaint:

> Complainants further claim that they are entitled to a large portion of the marginal line loss surplus because the Commission has recognized the value of arbitrage in energy markets. We do not dispute the value of arbitrage in energy markets. However, such arbitrage is valuable because the arbitrageur faces the marginal cost of energy and can therefore make transactions that reduce price divergence between the Day-Ahead and Real-Time markets. For arbitrage to be effective, arbitrageurs therefore should pay and receive the market price for energy, which in this case includes marginal line losses. As long as arbitrageurs receive and pay the marginal energy price, arbitrage is not jeopardized, and we see no entitlement to additional payment of surplus unrelated to the transmission charges. ***Indeed, payment of the surplus to arbitrageurs that is unrelated to the transmission costs could distort arbitrage decisions and reduce the value of arbitrage by creating an incentive for arbitrageurs to engage in purchase decisions, not because of price divergence, but simply to increase marginal line loss payments.***

Black Oak Energy, Order Denying Reh'g in Part & Granting Reh'g in Part, 125 F.E.R.C. ¶ 61,042 at P 43 (Oct. 16, 2008) (emphasis added) (citing Order Denying Complaint, 122 F.E.R.C. ¶ 61,208 at P 51). In the same order, the Commission also observed that paying transmission loss credits to financial traders "would provide an incentive for the arbitrageurs to conduct trades simply to receive a larger credit." *Id.* at 125 F.E.R.C. ¶ 61,042 at P 38 n.46.

Ultimately, the Commission approved the inclusion of virtual traders in the allocation of TLCs with *no limitation* other than that the traders pay into the fixed costs of the system, which as the Commission expressly recognized, would include UTC transactions. *See Black Oak Energy*, Order Accepting Compliance Filing, 128 F.E.R.C. ¶ 61,262 at P 26 (Sept. 17, 2009)

("As PJM acknowledges, some arbitrageurs or virtual traders pay transmission access charges related to Up-To Congestion transactions, which contribute to the fixed costs of the transmission system, and which should be included in the allocation process . . . ."). Thus, having at least *twice* addressed the issue of including virtual traders in the allocation of TLCs, the Commission required PJM to revise its tariff to include virtual traders. And despite having had the opportunity to circumscribe the very conduct at issue in this matter, the Commission did *not* ask PJM to limit or qualify the virtual traders' receipt of rebates for UTC transactions, nor did the Commission issue any pronouncement or order advising virtual traders that it would consider trading for the rebates to be wrongful conduct. In other words, the Commission: (1) evaluated and assessed how adding TLC payments would affect trading behavior, (2) changed the incentives of the trade, and (3) never cautioned that there would be anything unlawful about virtual traders following those incentives. In sum, the Commission anticipated that traders would alter their behavior – and that is exactly what happened.[5]

[5] FERC also failed to provide fair notice that the defendants could be liable based on the receipt of rebates that allegedly should have gone to other market participants – what FERC calls the "misdirection" of the rebates. Compl. ¶¶ 20, 79. This supposed "harm" cannot be the basis for liability because nobody was entitled to any particular "share" of the rebates. The Commission had previously found that no entity was entitled to receive any particular amount of credits. *Black Oak Energy, LLC*, 125 F.E.R.C. ¶ 61,042 at P 12 (***"[T]he Commission reiterated that no party is entitled to receive any particular amounts through disbursement*** [of the credit that inevitably results from using the marginal line loss methodology], since the price each is paying (based on marginal line losses) is the correct marginal cost for the energy each is purchasing." (emphasis added) (citing *Black Oak Energy*, Order Denying Complaint, 122 F.E.R.C. ¶ 61,208 at P 46)). Thus, Dr. Chen and Powhatan were not depriving other traders of anything to which they were entitled. Rather, Dr. Chen and Powhatan were entitled to the transmission loss credits that they collected based on their payment of the transmission costs and other fixed costs of the system. Accordingly, the defendants did not have *any* notice that the credits they collected supposedly "should have" gone to other traders. Indeed, it is ironic that FERC is now claiming that the "harm" to other traders is that they lost out on rebate revenue when FERC's case theory is that UTC traders were not even allowed to pursue such revenue in the first place.

Moreover, in Order No. 670, which implemented the anti-manipulation rule, the Commission established a "safe harbor" whereby "[i]f a market participant undertakes an action or transaction that is explicitly contemplated in Commission-approved rules and regulations, we will presume that the market participant is not in violation of the Final Rule." *See Prohibition of Energy Mkt. Manipulation*, 114 F.E.R.C. ¶ 61,047 at P 67 (Jan. 19, 2006) ("Order No. 670") (setting forth the elements of the Commission's anti-manipulation rule, codified at 18 C.F.R. §1c2(a) (2006)). That is the situation here: as explained above, the relevant Commission orders explicitly contemplated – indeed, they explicitly *said* – that including virtual traders in the allocation of transmission loss credits would encourage them, for example, to "make trades that would not be profitable based solely on price differentials alone" and to "engage in purchase decisions, not because of price divergence, but simply to increase marginal line loss payments." If the safe harbor does not apply here, that portion of Order No. 670 is utterly meaningless.

There is nothing complicated or mysterious about this. One does not need any special expertise in the energy markets to understand the import of the relevant orders here. Their significance is plain on their face. Given the above, how can Powhatan possibly have received fair notice that FERC would consider the trading at issue to be illegal? The FERC Enforcement Staff's Report that is attached to the complaint offers two arguments that presumably FERC will trot out again in response to this motion. Neither argument has any merit. First, FERC claims that certain parties (the "Financial Marketers' coalition") in the *Black Oak* proceedings "promised" that they would not make trades for the purpose of receiving rebates, and second, it says that the relevant orders should be read to have "condemned" the very trading that they allow. Report at 59-71.

The first argument is entirely irrelevant. It does not matter what any of the parties in the

Black Oak proceedings did or did not promise. It is axiomatic that the Commission speaks through its orders – not through what certain parties may or may not have said to the Commission.

The same goes for the second argument: it does not matter what the FERC Staff thinks the Commission *meant to say* in its orders. Because the Commission speaks through its orders, all that matters is what the orders *actually say*. The orders note the consequences that the Commission anticipated if it approved the new revenue stream provided by the rebates (specifically, that traders would make trades that would not be profitable absent the rebates) and then the orders approve this new revenue stream – never stating that there were any legal problems with those envisioned consequences. Under the Staff's tortured reading, however, the orders must be read also to say "and furthermore we condemn these consequences, think that they are illegal and nobody should trade this way." But they *do not* say that, or anything like it.

If the Commission really *meant* to signal in the *Black Oak* orders that trading like Dr. Chen's would be considered market manipulation, it simply should have said so. This would have been easy enough to do. For example, in *Midwest Independent Transmission System Operator, Inc.*, 108 F.E.R.C. ¶ 61,236 (Sept. 16, 2004), the Commission considered how certain "grandfathered" transmission agreements ("GFAs") should be treated in the context of then newly adopted features of the Midwest ISO energy markets. Dr. William Hogan submitted testimony in the GFA proceeding, where he explained how a "carve-out" for GFAs might create opportunities for market manipulation. The Commission agreed with this concern and directed the IMM to monitor for such behavior and report to the Commission:

> We agree with testimony submitted by Dr. Hogan that a GFA carve-out *could create opportunities for market manipulation* . . . . Thus, we will require the IMM to monitor GFA customers for

> gaming behavior and provide an informational report to the Commission prior to the second FTR allocation. We further note that . . . Market Behavior Rule 2 . . . would apply to scheduling behavior of GFAs.

Id. at P 101 (emphasis added) (footnotes omitted).

Just as it did in the GFA proceeding, when the opportunity for manipulation has been brought to the Commission's attention, the Commission has routinely said something about it. More specifically, the Commission has put the regulated community on notice by describing the potential for manipulation or gaming and taking steps like directing the market monitor to be on the lookout and report such conduct, or advising the market participants that the conduct might violate the governing rules, including the prohibition on market manipulation.[6]

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[6] *E.g.*, *Sw. Power Pool, Inc.*, 144 F.E.R.C. ¶ 61,255 at PP 30-31 (Sept. 30, 2013) (because of concern over "gaming" by certain GFA customers, "we direct SPP to revise its Tariff to provide that the Market Monitor will monitor for gaming by GFA customers and to report any such instances to the Commission"); *Midwest Indep. Transmission Sys. Operator, Inc.*, 137 F.E.R.C. ¶ 61,213 at P 87 (Dec. 15, 2011) (discussing concerns that proposed "reference levels" will encourage gaming and market 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.*, 134 F.E.R.C. ¶ 61,211 at P 131 & n.161 (Mar. 17, 2011) (discussing arguments that offering risk of retirement Capacity Procurement Mechanism designations "may create significant market distortions, such as the opportunity for gaming" and concluding that CAISO's proposal contained safeguards against "manipulat[ion]" because CAISO market participants are bound by rules including "the prohibitions of market manipulation in the CAISO tariff and the Commission's rules and regulations"); *Cal. Indep. Sys. Operator Corp.*, 132 F.E.R.C. ¶ 61,045 at P 66 (July 15, 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"); *PJM Interconnection, L.L.C.*, 122 F.E.R.C. ¶ 61,082 at P 68 (Jan. 31, 2008) (addressing concerns over "gaming" in connection with "adoption of a postage-stamp rate design for 500 kV and above projects" and stating that PJM tariff "contains protective provisions to prevent any potential gaming" and customers can "bring inconsistencies to the attention of PJM"); *Midwest Indep. Transmission Sys. Operator, Inc.*, 114 F.E.R.C. ¶ 61,106 at P 45 (Feb. 3, 2006) ("[W]e are mindful that gaming to increase the voltage level of some projects so as to be eligible for regional cost sharing could be attempted; but we expect the Midwest ISO . . . to carefully monitor projects in this area.").

Likewise, it would have been very easy for the Commission to have prohibited trading like that alleged here. It would have taken no more than the stroke of a pen. But the Commission did *not* do so. In marked contrast to the orders cited above, the *Black Oak* orders never mention "gaming." They never mention "manipulation." They do not even direct the market monitor to monitor or report back on any concerns raised about the trading incentives. By failing to do so, when the Commission has regularly done so in the past, the *Black Oak* orders strongly signaled that the Commission did not consider the conduct at issue to be manipulation.

In short, the *Black Oak* orders were adopted in the full light of day, with explicit discussion of the incentive effects and the likely implications for trading strategies of market participants. These incentives and implications were known and accepted by the Commission. It would be completely bizarre for the Commission to issue orders requiring PJM to pay rebates to UTC traders and to say nothing about gaming or manipulation – and yet for traders to be expected to read the Commission's mind and conclude that the Commission's silence means that it would be market manipulation for traders to pursue the rebates. But that is the exact argument that the FERC Enforcement Staff is peddling here. The Court should reject the Staff's counter-textual (and nonsensical) reading of the orders.

Even worse, in its Order Assessing Civil Penalties, the Commission states that "[b]ecause the Commission's *Black Oak* orders did not explicitly contemplate trading UTCs for the purpose of capturing MLSA revenues, Respondents cannot now claim to have reasonably concluded that their trades would not be subject to Commission scrutiny." Order ¶ 122. This is nonsense. As explained above, the orders state that paying rebates to UTC traders could "creat[e] an incentive for [traders] to engage in purchase decisions, not because of price divergence, ***but simply to increase marginal line loss payments***" and "would provide an incentive for [traders] to conduct

trades ***simply to receive a larger credit***." *Supra* at 9; *see also* Report at 62-63. If that is not "contemplat[ing] trading UTCs for the purpose of capturing MLSA revenues," Order ¶ 122, then we might as well just give up and say that the words in the orders mean nothing at all.

Finally, the Commission extends this injustice by suggesting, in the very next sentence of the Order, that "[w]hen it is unclear whether conduct would be legal, the risk associated with pursuing that conduct falls on the market participant." *Id.* That is not the law – in fact, it is the exact *opposite* of the law. When a regulatory pronouncement makes it "unclear" whether conduct would be legal, constitutional principles of due process and fair notice prohibit the government from pursuing civil penalties for that conduct. That is black letter law, both in this Circuit and elsewhere. For FERC to casually bat this away with the back of its hand is emblematic of the agency's approach to this entire investigation and helps to illustrate why Powhatan and Dr. Chen have been so frustrated with it for so long. It is time for FERC to have to follow the law and the Constitution.

B. The Relevant Due Process/Fair Notice Case Law Is Overwhelmingly In Powhatan's Favor.

1. The Complaint Should Be Dismissed Based On The Binding "Fair Notice" Precedent Of *United States v. Hoechst Celanese Corporation* And *First American Bank Of Virginia v. Dole* In The U.S. Court Of Appeals For The Fourth Circuit.

United States v. Hoechst Celanese Corp., 128 F.3d 216 (4th Cir. 1997), and *First American Bank of Virginia v. Dole*, 763 F.2d 644 (4th Cir. 1985), establish the parameters of fair notice when the government seeks to impose civil penalties in this Circuit. As the Fourth Circuit has explained, "we have concluded that because civil penalties are 'quasi-criminal' in nature, parties subject to such administrative sanctions are entitled to similar 'clear notice'" as that found in criminal law. *Hoechst Celanese*, 128 F.3d at 224 (citing *First Am.*, 763 F.2d at 651 n.6).

More specifically, "[a] regulation [] which allow[s] monetary penalties against those who violate [it], . . . must give . . . fair warning of the conduct it prohibits or requires, and it must provide a reasonably clear standard of culpability to circumscribe the discretion of the enforcing authority and its agents." *Id.* (quoting *Diamond Roofing Co. v. OSHRC*, 528 F.2d 645, 649 (5th Cir. 1976) (internal quotation marks omitted)).

In *Hoechst Celanese*, the United States initiated suit, on behalf of the EPA, against Hoechst Celanese Corporation ("HCC") for alleged violations of the plant emissions standard for benzene. *Id.* at 219. The regulations controlled the amount of benzene that could be emitted into the atmosphere, but exempted "[a]ny equipment in benzene service that is located at a plant site designed to produce or *use* less than 1,000 megagrams of benzene per year." *Id.* at 219-20 (emphasis in original). The question in the case was what does "use" mean in the exemption. *Id.* at 220. The EPA argued that "use" should be interpreted broadly, to mean "utilization, employment, or putting in place." *Id.* HCC countered that "use" should be interpreted narrowly, to mean only "consumption." *Id.* Because the plant in question continually recycled benzene, the total quantity it "used" never exceeded 1,000 megagrams a year and thus qualified for the exemption, according to HCC's theory. *Id.*

The Court began its analysis with the plain language of the regulations, and noted that the government's interpretation had several things going for it. The government's broad interpretation of "use" (1) was consistent with the ordinary meaning of the word, (2) was not nonsensical, (3) was consistent with the purpose of the Clean Air Act, and (4) was consistent with the purpose of the exemption itself. *Id.* at 221-22. Nevertheless, there was nothing in the regulations that "mandate[d]" the government's interpretation. *Id.* at 225. Thus, the Court could not hold that the regulations "clearly put HCC on notice that the [plant in question] did not

qualify for an exemption." *Id.* In sum, HCC "had reason to believe that its interpretation of the exemption – equating 'use' to 'consumption' – was accurate." *Id.* at 226. Accordingly, the Court held that HCC did not have fair notice of the EPA's interpretation of the regulations prior to 1989, when the EPA directly informed HCC officials of the interpretation. *Id.* at 227.

Applying these lessons to the instant matter, it is obvious that Powhatan did not have fair notice that FERC would consider the trading at issue to be illegal. Even though the government's interpretation in *Hoechst Celanese* had several things going for it, the Court *still* found a lack of fair notice because there was nothing in the regulations that "mandated" the government's interpretation, and HCC had an objective "reason to believe" that its contrary interpretation was accurate. Here, FERC's interpretation of the relevant *Black Oak* orders has absolutely *nothing* going for it. As explained above, FERC's bizarre interpretation ignores the plain language of the orders. *Supra* at 11-14. Indeed, FERC's interpretation would make the words of the orders utterly meaningless. At the very least, FERC's atextual interpretation is certainly not "mandated" by the orders. And Powhatan, like HCC, had an objective "reason to believe" that a contrary interpretation of the orders was correct because it had reason to believe that the orders mean what they say – namely, that paying rebates to UTC traders could "creat[e] an incentive for [traders] to engage in purchase decisions, not because of price divergence, ***but simply to increase marginal line loss payments***" and "would provide an incentive for [traders] to conduct trades ***simply to receive a larger credit***." *Supra* at 9. Having specifically highlighted these incentives in the *Black Oak* orders and then affirmatively changing the tariff to include those incentives – while never stating that there would be anything unlawful about virtual traders following those incentives – FERC cannot now penalize Powhatan for following the incentives.

In *First American*, plaintiff First American sought reversal of a Civil Aeronautics Board

("CAB") order finding that First American violated CAB charter flight regulations by not adequately monitoring a client's bank deposits of charter participants' funds. *First Am.*, 763 F.2d at 645. The Court reversed the CAB order on the grounds that the regulations merely required First American to exercise ordinary care to determine the origin of any possible irregularities in the client's deposit practices; First American did not have a heightened, affirmative duty to monitor the client's deposits for any irregularities. *Id.* at 650-51. First American was "entitled to clear notice of any duty it supposedly had under the charter regulations to monitor [the client's] deposits. That notice was never provided." *Id.* at 651 n.6.

The Court's observations at the end of the opinion are most relevant here. It noted that "[a]lthough a regulation requiring depository banks to monitor charter deposits may be desirable and salutary, we cannot retroactively impose such a duty." *Id.* at 652. Instead, "[t]hat duty must await another day and another regulation." *Id.* Nor is it for the Court to impose such a duty: "the judicial role is limited to enforcement because '[t]he responsibility to promulgate clear and unambiguous standards is upon' the administrative agency alone." *Id.* at 652 n.7 (quoting *In re Metro-E. Mfg. Co.*, 655 F.2d 805, 810 (7th Cir. 1981)). Additionally, its conclusion that the existing charter regulations did not place any affirmative duty on First American to monitor charter deposits was bolstered by the fact that CAB had *proposed* regulations (that had not been adopted) that placed upon First American "the very duty that the CAB now argues already exists under current regulations." *Id.* 650 n.5. If such a duty already existed, "there would have been no reason for the CAB to have proposed any regulatory changes. We cannot believe that the CAB's proposed regulations were utterly superfluous." *Id.* Finally, the Court stated that "[t]he quasi-criminal nature of civil penalties counsels caution and pause before we resort to such a drastic remedy. However, the CAB never exercised the caution and circumspection so clearly

called for when it imposed civil penalties on First American for the violation of a duty that its own regulations neither contemplated nor established." *Id.* at 651-52 (footnote omitted).

Here, FERC and PJM changed the tariff in September 2010 in order to prevent traders from receiving the rebates, almost immediately after PJM asked Dr. Chen to stop his trading. *Supra* at 4. Yet FERC now claims that Dr. Chen's trading was prevented all along by the anti-manipulation rule. Compl. ¶ 60. This approach cannot be squared with *First American.* If the anti-manipulation rule had already imposed a duty on Dr. Chen to avoid the trades at issue, "there would have been no reason" for FERC "to have proposed any regulatory changes." *First Am.*, 763 F.2d at 650 n.5. Just as in *First American*, "[w]e cannot believe" that FERC's new tariff was "utterly superfluous." *Id.* Instead, what FERC and PJM did by enacting a new tariff – while simultaneously pretending that the anti-manipulation rule prohibited the conduct at issue all along – was attempt to apply a new duty on Dr. Chen and Powhatan retroactively. That is forbidden by *First American. Id.* at 652. Although a duty preventing Dr. Chen from considering the rebates might be "desirable and salutary" from FERC's perspective, neither FERC nor a court may "retroactively impose such a duty." *Id.* As the *First American* court explained, "[t]hat duty must await another day" – which is exactly what happened when FERC and PJM enacted the new tariff *after* the trading at issue. *Id.*

In this case, FERC has acted with anything but the type of "caution and pause" that the Court in *First American* counseled should apply before resorting to such a "drastic remedy" as severe civil penalties. *Id.* at 651. FERC has disregarded the plain language of the *Black Oak* orders and the most basic notions of fair notice and fair play, breezily concluding that Powhatan should pay a civil penalty of nearly $19 million, in addition to disgorgement. Compl. ¶¶ 95, 100. The Commission has even gone so far as to arrogantly (and erroneously) announce that "[w]hen

it is unclear whether conduct would be legal, the risk associated with pursuing that conduct falls on the market participant." Order ¶ 122. This is the antithesis of "the caution and circumspection so clearly called for" when FERC "imposed civil penalties" on Powhatan "for the violation of a duty that its own regulations neither contemplated nor established." *First Am.*, 763 F.2d at 651-52. Based on binding precedent, the complaint should be dismissed.

2. The Fair Notice Case Law In Other Jurisdictions Also Dictates That The Complaint Should Be Dismissed.

As discussed above, the complaint should be dismissed based on *Hoechst Celanese* and *First American*. But those cases are by no means anomalous. They are consistent with fair notice precedent throughout the country.

For example, in *Upton v. SEC*, 75 F.3d 92 (2d Cir. 1996), the U.S. Court of Appeals for the Second Circuit found a due process violation in circumstances in which the individual there had much more notice than Powhatan had here. In *Upton*, the SEC brought an action against Mr. Upton, the chief financial officer of the brokerage firm FiCS, for failing to supervise an employee who allegedly aided and abetted a violation of SEC Rule 15c3-3(e), which was designed to prevent broker-dealers from using funds or securities on behalf of customers to finance non-customer transactions. Specifically, that rule required brokers to use a "special reserve bank account" and stated that computations to determine the minimum amount to be kept in the account were to be made "weekly, as of the close of the last business day of the week" and the deposit should be made "no later than 1 hour after the opening of banking business on the second following business day." *Id*. at 93 (internal quotation marks and citation omitted).

At issue, FiCS engaged in a "pay-down" practice where the firm's money management department "paid down loans collateralized by customer securities just before the weekly Rule

15c3-3(e) computation and replaced them with unsecured loans" at a higher interest rate. *Id*. On the next business day, FiCS paid down the unsecured loans and "reinstated the customer-secured loans." *Id*. By doing this, FiCS was able to reduce its weekly reserve requirement by "$20 million on average and by as much as $40 million in some weeks." *Id*. at 94.

FiCS engaged in this "pay-down" practice from April 1988 until May 26, 1989. In November 1988, an NYSE examiner contacted an assistant in the money management department and advised that the "pay-down" practice was "questionable and should be stopped." *Id*. at 95. However, the head of the department ignored the warning. In May 1989, Mr. Upton received a telephone call from SEC staff advising him that the "pay-down" practice "violated the spirit of [the] Rule." *Id*. Mr. Upton then instructed the firm's money management department to stop the practice.

On August 23, 1989, the SEC circulated an interpretation memo, in which "for the first time it advised its members and member organizations that the paydown practice might violate Rule 15c3-3(e)." *Id*. Two years later, the SEC instituted public proceedings against Mr. Upton and the head of his money management department, alleging that his firm's "pay-down" practice from April 1988 until May 1989 violated Rule 15c3-3(e) by resulting in reserve bank account deficiencies averaging $20 million per week, placing broker-dealers and customers at "substantial risk." *Id*.

An evidentiary hearing was held before an ALJ, who issued an initial decision censoring Mr. Upton. The ALJ held that the FiCS's "pay-down" practice was "simply a device designed to evade the requirements of [Rule 15c3-3(e)]." *Id*. at 96. The ALJ further found that "[b]ecause FiCS was able to use customer funds to finance proprietary activities, the very practice the Rule was designed to prevent, FiCS did not require specific notice that this circumvention of the Rule

amounted to a violation." *Id*. The SEC affirmed the ALJ's decision. The Second Circuit reversed.

Mr. Upton claimed that he should not have been held liable for violating the rule because "the Commission knew about the paydown practice well before the underlying events in th[e] action took place and yet did not publicly condemn it until Interpretation Memo 89-10 was released on August 23, 1989." *Id*. at 98. The court noted that it was "undisputed that FiCS complied with the literal terms of the Rule at all times." *Id*. at 94. The court also noted that the SEC had begun investigating the paydown practice at several firms "as early as 1986" and had "referred several such 'violations' of Rule 15c3-3(e) to the New York Stock Exchange and [had] instructed individual broker-dealers to discontinue the practice." *Id*. at 97. However, the Exchange had informed the SEC that it would not cite the firms for any violations because there had been no written interpretation with respect to the practice. In December 1987, the SEC had brought an administrative proceeding against another brokerage firm for engaging in a "pay-down" practice. That case had settled and the SEC had issued a consent order. *Id.*

In vacating the SEC's order, the Second Circuit noted that the SEC "was aware that brokerage firms were evading the substance of Rule 15c3-3(e) by temporarily substituting customer loans on the Rule's computation date as early as 1986, two years before the events in this case took place. Apart from issuing one consent order carrying 'little, if any, precedential weight,' ***the Commission took no steps to advise the public*** that it believed the practice was questionable until August 23, 1989, after Upton had already stopped the practice." *Id*. at 98 (emphasis added). Accordingly, the court found that the SEC's order censoring Mr. Upton violated due process because Mr. Upton "was not on reasonable notice that FiCS's conduct might violate the Rule." *Id.*; *see also KPMG, LLP v. SEC*, 289 F.3d 109, 115-16 (D.C. Cir.

2002) (following *Upton* and concluding that the SEC erred in finding that KPMG was in violation of a rule prohibiting the receipt of contingent fees because KPMG did not have fair notice that its success fee arrangement ran afoul of the rule from "any interpretation . . . the Commission ha[d] ever attached to [the] Rule").

The due process violation here would be much more apparent than the violation in *Upton*. First, Mr. Upton and his firm's money management department had received a warning from an NYSE market monitor about their "pay-down" practice six months after they began engaging in that practice. Despite the warning, they continued to engage in the "pay-down" practice for *another six months* before the SEC told them to shut it down. Here, as soon as Dr. Chen received a warning from Dr. Bowring on August 2, 2010, he stopped conducting the trades in question. *Supra* at 4. Second, although the SEC had issued a previous consent order following the settlement of claims related to a "pay-down" practice at another brokerage firm, that *still* was not enough to put Mr. Upton on reasonable notice that a "pay-down" practice was unlawful. Here, there were no prior PJM pronouncements or Commission orders related to the transmission loss credits even suggesting that Dr. Chen's trading was illegal. Just the opposite: the Commission had anticipated the type of trading at issue here and nonetheless approved PJM's inclusion of virtual UTC traders in the allocation of the transmission loss credits.

In addition to the *Upton* case, a recent decision out of the Southern District of New York is particularly instructive. In *SEC v. Pentagon Capital Management*, 844 F. Supp. 2d 377 (S.D.N.Y. 2012), *vacated in part on other grounds*, 725 F.3d 279 (2d Cir. 2013), the SEC brought an enforcement action against Pentagon Capital Management PLC ("Pentagon") and Lewis Chester ("Chester"), Pentagon's former Chief Executive Officer, alleging that between 1999 and 2003, Pentagon and Chester had orchestrated a scheme to defraud mutual funds

through late trading and deceptive market timing in violation of, among other things, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Following a bench trial, the court granted in part and denied in part the relief requested by the SEC. Although the court found violations of securities law related to defendants' late trading, the court concluded that the defendants had not engaged in market manipulation in violation of Section 10(b) and Rule 10b-5 by pursuing a strategy of market timing.

With regard to the SEC's market timing claim, the court noted that prior to 2003, there were no clear rules regarding market timing. *Id*. at 414. The court observed that prior to 2003, "the SEC had never commenced an enforcement proceeding against any mutual fund, market timer, or securities firm for market timing." *Id*. at 392. Specifically, the court stated:

> ***Defendants' actions thus took place in an atmosphere of uncertainty.*** There were no definitions or prohibitions from the responsible agency with respect to market timing, and the funds' enforcement of their provisions relating to timing was discretionary, inconsistent, and occasionally conflicted with capacity agreements. The SEC issued no guidelines as to which fund provisions it might seek to enforce and, of course, prior to the Canary enforcement action by the NYAG in September 2003, the SEC had not initiated any proceedings to obtain the relief sought here.

Id. at 415 (emphasis added). Indeed, it was only after the time period at issue, in April 2004, that the SEC adopted a market timing rule requiring mutual funds to disclose their policies toward market timing. *Id.* at 392.

Accordingly, the court concluded that **"*the lack of regulation or clear rules or practices regarding market timing during the period in question cannot be remedied by a finding of liability.*"** *Id*. at 418 (emphasis added). "Litigation in the absence of clear standards may further raise due process concerns, upsetting the basic notion that individuals have fair notice of the

standards under which they may be held liable. Prospective regulation by the SEC and clear rules by the funds are preferable to *post hoc* litigation." *Id*. (internal citation omitted). Those words are of particular force here.

In the instant matter, just as in *Pentagon*, there were no prohibitions from the Commission or PJM with respect to the collection of TLCs. Powhatan had no way of knowing that responding to the incentives created by the TLCs could be considered prohibited conduct. Given that the Commission had specifically acknowledged such incentives and declined to prohibit or discourage trading influenced by such incentives, Powhatan had every reason objectively to believe that the trading was lawful. The paramount concern of due process is "that individuals have fair notice of the standards under which they may be held liable." *Pentagon*, 844 F. Supp. 2d at 418. That concern is obviously front and center here.

While *Upton* and *Pentagon* are particularly relevant, there is an overwhelming amount of additional due process authority that would bar any liability here for supposed market manipulation. *E.g.*, *Fox Television*, 132 S. Ct. at 2320 (setting aside notices of liability because broadcasters did not have sufficient notice of what was proscribed); *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 510 (2009) (noting that FCC did not seek a penalty where a change in policy had occurred, preventing the subject from having "requisite notice to justify a penalty" (internal quotation marks and citation omitted)); *United States v. AMC Entm't, Inc.*, 549 F.3d 760, 768 (9th Cir. 2008) (stating that "those regulated by an administrative agency are entitled to know the rules by which the game will be played" and holding that fair notice precluded the lower court from requiring AMC to retrofit its theatres built before the government announced its interpretation of the statute at issue (internal quotation marks and citations omitted)); *Fabi Constr. Co. v. Sec'y of Labor*, 508 F.3d 1077, 1085-86 (D.C. Cir.

2007) (holding that petitioners were deprived of fair notice because secretary announced its interpretation of regulation for the first time in an adjudicatory proceeding); *Trinity Broad. of Fla., Inc. v. FCC*, 211 F.3d 618, 619, 628-32 (D.C. Cir. 2000) (discussing fair notice doctrine and finding "neither the regulation nor the Commission's related statements gave fair notice" of a requirement sufficient "to justify punishing someone for violating it"); *Gen. Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (explaining that "when sanctions are drastic . . . 'elementary fairness compels clarity' in the statements and regulations setting forth the actions with which the agency expects the public to comply." (quoting *Radio Athens, Inc. v. FCC*, 401 F.2d 398, 404 (D.C. Cir. 1968))); *Satellite Broad. Co. v. FCC*, 824 F.2d 1, 3-4 (D.C. Cir. 1987) (stating that "[t]raditional concepts of due process incorporated into administrative law preclude an agency from penalizing a private party for violating a rule without first providing adequate notice of the substance of the rule" and vacating FCC's orders dismissing applications where FCC failed to give full notice of its interpretation); *Diamond Roofing Co.*, 528 F.2d at 649 (explaining that a regulated entity – in this case, an employer –"is entitled to fair notice in dealing with [its] government," and that "statutes and regulations which allow monetary penalties against those who violate them . . . must give . . . fair warning of the conduct" that is "prohibit[ed] or require[d]"); *Peterson v. ConAgra Foods, Inc.*, No. 13-cv-3158-L (NLS), 2014 WL 3741853, *4 (S.D. Cal. July 29, 2014) (granting motion to dismiss because "[t]o hold that ConAgra should have been complying with a regulation that was not explicitly clarified until November 19, 2012 would violate due process because ConAgra was not on fair notice.").

C. Reliance On The General Language Of The Anti-Manipulation Rule Cannot Save FERC Here Because Specific Regulatory Pronouncements Trump General Ones.

In the face of the overwhelming amount of constitutional authority arrayed against it, FERC in its opposition will fall back on the argument that Powhatan had fair notice all along because of the existence of the anti-manipulation rule, which supposedly prohibited Dr. Chen's trades. There are several reasons why this argument does not work. First, it ignores the obvious import of the *Black Oak* orders already discussed above. Pointing to the general language of the anti-manipulation rule (which prohibits using a "fraudulent device, scheme, or artifice" or engaging in any act that would operate as a "fraud or deceit") will not make the *Black Oak* orders go away. Even assuming, for the sake of argument, that the anti-manipulation rule should somehow be taken into account, the most that can be said in FERC's favor is that the combination of the *Black Oak* orders and the anti-manipulation rule created a confusing situation in which Powhatan did not have "clear notice" that FERC would consider pursuing the rebates to be illegal. *Hoechst Celanese*, 128 F.3d at 224; *First Am.*, 763 F.2d at 651 n.6.

Second, the anti-manipulation rule is irrelevant here because FERC and PJM changed the tariff almost immediately after PJM asked Dr. Chen to stop his trading. *Supra* at 4. If the anti-manipulation rule had *already* imposed a duty on Dr. Chen to avoid the trades at issue, "there would have been no reason" for FERC "to have proposed any regulatory changes." *First Am.*, 763 F.2d at 650 n.5. As the Fourth Circuit explained, "[w]e cannot believe" that FERC's new tariff was "utterly superfluous." *Id.* Instead, what FERC and PJM did by enacting a new tariff and then pursuing this case was attempt to apply a new duty on Powhatan and Dr. Chen retroactively, which is forbidden by *First American. Id.* at 652.

Third, the anti-manipulation rule is irrelevant here because it is black letter law that a

specific regulatory pronouncement trumps a general one. *E.g.*, *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 170 (2007) (holding that specific regulation governed over general regulation); *Spreckels v. Helvering*, 315 U.S. 626, 628 (1942) (holding "that a general regulation designating 'commissions' as one of a long list of deductible business expenses is not controlling in the face of a specific regulation pertaining to commissions on securities transactions" (footnote omitted)); *Covenant Med. Ctr., Inc. v. Sebelius*, 424 F. App'x 434, 437 (6th Cir. 2011) (interpreting separate regulations and stating that applying specific regulation over general regulation "respects the interpretive principle that 'a specific provision . . . controls ones of more general application'" (quoting *Bloate v. United States*, 599 U.S. 196, 227 (2010)); *Tasker v. DHL Ret. Sav. Plan*, 621 F.3d 34, 43 (1st Cir. 2010) (analyzing different provisions in 26 C.F.R. § 1.411(d)-4 and holding that specific provisions govern general provisions because "[i]t is a conventional canon of legal interpretation that specific provisions trump more general ones." (internal quotation marks and citation omitted)); *Miles v. Phenix City Hous. Auth.*, No. 3:11-CV-216-WKW, 2011 WL 2580390, at *3 (M.D. Ala. June 29, 2011) (holding specific provision in 24 C.F.R. § 982.555 governed over general provision because "[p]rinciples of regulatory interpretation disfavor reliance on broad catch-all provisions when a more precise provision is applicable"); *Title Redacted by Agency*, No. 08-12 904, 2015 WL 3529208, at *5 (Bd. Vet. App. Apr. 21, 2015) (holding that a specific regulation, 38 C.F.R. § 4.71a, trumps a general regulation, 38 C.F.R. § 4.59); *Sec'y of Labor v. Carborundum Co., Electro Mineral Div.*, OSHRC Docket No. 79-860, 1982 WL 189097, at *18 (Occupational Safety Health Review Comm'n Sept. 29, 1982) (vacating citations against company based on a general regulation where a specific regulation applied to the circumstances and stating that "[w]here a given regulation governs the conduct of a specific activity, it is improper to invoke the general duty clause because that was

not the intent of the general duty clause . . . and it creates problems of fair notice”).[7]

What matters, then, when assessing fair notice is what FERC has to say about *the specific trading at issue*, which is found in the *Black Oak* orders. General pronouncements against “fraud” or “deceit” in the anti-manipulation rule are of no consequence to the question here when FERC has specifically addressed the exact trading at issue. Similarly, any analogies or comparisons that FERC might try to draw between the trading at issue and other trading that has

[7] This principle that the specific trumps the general also applies, of course, when interpreting statutes. *E.g.*, *United States v. Estate of Romani*, 523 U.S. 517, 532 (1998) (holding that specific provisions found in the Tax Lien Act of 1966 governed over the broad federal priority statute); *Morton v. Mancari*, 417 U.S. 535, 550-51 (1974) (holding that the Indian Preference Statute applies because it “is a specific provision applying to a very specific situation” whereas the Equal Employment Opportunity Act of 1972 is of general application and recognizing that “a specific statute will not be controlled or nullified by a general one”); *Bulova Watch Co. v. United States*, 365 U.S. 753, 758 (1961) (holding specific statute governed over general statute and recognizing that “it is familiar law that a specific statute controls over a general one ‘without regard to priority of enactment’” (citations omitted)); *Bonneville Power Admin. v. F.E.R.C.*, 422 F.3d 908, 916 (9th Cir. 2005) (interpreting different provisions in § 201 of the Federal Power Act and holding that FERC’s interpretation of the Act as granting FERC broad authority overlooked the principle that “the specific prevails over the general” where specific provision in § 201 limited FERC’s authority); *Escondido Mut. Water Co. v. F.E.R.C.*, 692 F.2d 1223 (9th Cir. 1982) (holding that section 4(e) of the Federal Power Act limits FERC’s authority under section 10(e) of the Act and to conclude otherwise would be inconsistent with “the most elementary canons of statutory construction” (citing *Clifford F. MacEvoy Co. v. United States*, 322 U.S. 102, 107 (1944) (“However inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the enactment.”))), *rev’d in part on other grounds* 467 U.S. 1267, 1235 (1984); *Jeffrey v. Trans Union LLC*, 273 F. Supp. 2d 725, 727 (E.D. Va. 2003) (reconciling different sections in the Fair Credit Reporting Act and holding that specific section governed because “[u]nder the principles of statutory construction, ‘a general statute must yield when there is a specific statute involving the same subject matter’” (quoting *Gordon v. Greenpoint Credit*, 266 F. Supp. 2d 1007, 1012-13 (S.D. Iowa 2003)); *Glavin v. Clinton*, 19 F. Supp. 2d 543, 551 (E.D. Va. 1998) (interpreting different sections of the Census Act of 1976 and holding that specific provisions trumped general provisions because “[a]s between two statutory provision[s] concerning the same topic, the more specific section governs the general. ‘The law is settled that “however inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the same enactment.”’” (quoting *Fourco Glass Co. v. Transmirra Prods. Corp.*, 353 U.S. 222, 228-29 (1957))).

been prohibited under the anti-manipulation rule are also irrelevant. Simply stated, because the *Black Oak* orders speak directly to the specific trading at issue, it is those orders – and only those orders – that address the key issue presented by this motion: did Powhatan and Dr. Chen receive fair notice that FERC would consider the trading at issue to be illegal? Plainly, the answer to that question is "no."

CONCLUSION

This case should be dismissed as a matter of law. FERC has alleged no facts that would have put Powhatan or Dr. Chen on fair notice that their conduct would violate the law. There are no factual disputes that need to be resolved here. There is simply the relevant law that existed at the time of the trading at issue, and what a person of "ordinary intelligence" would have drawn from it. For all of the reasons set forth above, this Court should dismiss the complaint with prejudice and thereby vindicate the constitutional principles of due process and fair notice.

Respectfully submitted,

Dated: October 19, 2015.

/s/ John Staige Davis, V
John Staige Davis, V
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, VA 23219
(804) 420-6000

William M. McSwain (admitted *pro hac vice*)
Christian E. Piccolo (admitted *pro hac vice*)
DRINKER BIDDLE & REATH LLP
One Logan Square, Suite 2000
Philadelphia, PA 19103-6996
(215) 988-2700

Attorneys for Powhatan Energy Fund LLC

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

FEDERAL ENERGY REGULATORY COMMISSION	:	
	:	
Plaintiff,	:	
	:	
v.	:	CIVIL ACTION
	:	NO. 3:15-CV-00452-MHL
POWHATAN ENERGY FUND LLC,	:	
HOULIAN "ALAN" CHEN,	:	
HEEP FUND, INC., and	:	
CU FUND, INC.	:	
	:	
Defendants	:	

[PROPOSED] ORDER

AND NOW, this ____ day of _______________, 201__, upon consideration of defendant Powhatan Energy Fund's motion to dismiss the complaint, plaintiff Federal Energy Regulatory Commission's opposition thereto, and defendant Powhatan Energy Fund's reply to the opposition, it is hereby ORDERED that the complaint shall be and hereby is DISMISSED with prejudice.

____
Honorable M. Hannah Lauck
United States District Court Judge

PROOF OF SERVICE

I hereby certify that on this day the foregoing defendant Powhatan Energy Fund's Motion to Dismiss the Complaint was filed electronically with the Clerk's Office for the U.S. District Court for the Eastern District of Virginia, and a copy was served via electronic mail to counsel for the plaintiff Federal Energy Regulatory Commission listed below:

Samuel G. Backfield, Esquire
Steven C. Tabackman, Esquire
Lisa L. Owings, Esquire
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426
samuel.backfield@ferc.gov
steven.tabackman@ferc.gov
lisa.owings@ferc.gov

Dated: October 19, 2015.

/s/ John Staige Davis, V

John Staige Davis, V
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, VA 23219
(804) 420-6000

Attorney for Powhatan Energy Fund LLC