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

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

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

In response to FERC's motion to add the eight present and former investors of Powhatan as relief defendants to enable recovery of funds subject to disgorgement, Powhatan largely concedes the key facts that form the basis of FERC's request.[1] Specifically, Powhatan does not appear to dispute the following:

- In 2010, shortly after learning of FERC's investigation, Powhatan distributed over $4 million to its eight investors, the Proposed Relief Defendants;
- The distributions were contingent in nature—that is, the Proposed Relief Defendants promised, as a condition of receiving the funds, to keep them liquid, not to spend them, and to return them to Powhatan if required to "settle" matters related to the FERC case;

[1] Defendant Powhatan Energy Fund, LLL's Opposition to Plaintiff Second Motion to Amend Complaint, FERC v. Powhatan Energy Fund, LLC, No. 3:15-cv-00452-MHL-MRC (E.D. Va. Dec. 17, 2021), ECF 274 (Response).

- Powhatan's own calculations precisely tracked each Proposed Relief Defendant's share of Powhatan's manipulative trading profits; and
- Kevin Gates (who is now one of two co-principals in Powhatan) repeatedly reminded the other Proposed Relief Defendants that the contingent distributions were "at risk," and made them aware of the Order Assessing Penalties, thus keeping the Proposed Relief Defendants apprised of FERC's claims against Powhatan.

Powhatan emphasizes that the fact and amount of the distribution were disclosed to FERC during the 2010 investigation, and even points to an email produced to FERC during that investigation where Kevin Gates told another Proposed Relief Defendant that everyone has to realize that they '"may have to return the money to Powhatan.'" Response at 11. However, production of a single email that makes a passing reference to possible return of the distributions does not amount to a full-throated disclosure of the redemption obligation. Indeed, Powhatan does not dispute that the terms of the distributions—*i.e.*, the documents signed by each Proposed Relief Defendant to obtain the funds—were not produced to FERC until this year, in this litigation.

Powhatan also raises several legal objections to adding the Proposed Relief Defendants to the case, none of which are a reason to deny the amendment:

First, Powhatan misreads the law regarding whether a proposed relief defendant can establish a legitimate ownership interest in the funds at issue. Powhatan argues that because the investors provided capital to invest in Powhatan, they exchanged "valuable consideration" and therefore have a "legitimate claim" to the funds. Response at 4-5. This self-serving argument is wrong both legally and factually. As a legal matter, an "ownership interest" is established when a person has exchanged genuine consideration, such as a good or service, directly in exchange

for the funds at issue. *See, e.g., CFTC v. Kimberlynn Creek Ranch,* 276 F.3d 187, 192 (4th Cir. 2002) ("[R]eceipt of funds as payment for services rendered to an employer constitutes one type of ownership interest that would preclude proceeding against the holder of the funds as a [relief] defendant."). Powhatan's attempt to conflate an investor distribution with something like the purchase of goods is controverted by decades of SEC and CFTC caselaw holding to the contrary. As a factual matter, the Proposed Relief Defendants' own treatment of the subject funds contradicts their argument that their ownership interest precludes them from being named as relief defendants. Per the terms of the recently discovered agreements, the Proposed Relief Defendants agreed to keep the funds liquid, not to spend the funds, and to return the funds on demand. This agreement makes the Proposed Relief Defendants analogous for equitable purposes to the custodial relief defendants who receive ill-gotten gains for safekeeping or as a gift, or to investors who received illegitimate gains derived from an illegal scheme, rather than legitimate investment gains. *See, e.g.*, *SEC v. George*, 426 F.3d 786, 798 (6th Cir. 2005) (approving of district court's exercise of jurisdiction over investors in firm that derived its funds from a Ponzi scheme rather than legitimate investment returns).

Second, Powhatan's claim that FERC's proposed amendment to capture the distribution of funds tied to the illegal trading would not relate back to the alleged manipulation itself is wrong. In Powhatan's phrasing, "alleged market manipulation does not relate back to internal company distributions." Response at 9. But, "internal company distributions" of illegal profits are not sacrosanct or immune from the Court's equitable reach in this case under the relation-back doctrine. Indeed, in both *SEC v. Montle*, 6 F. App'x 749, 754 (2d Cir. 2003) (unpublished), and Ruling and Order, FTC v. Bronson Partners, LLC et al., No. 3:04CV1866 (SRU) (D. Conn. June 8, 2005), ECF No. 219, the courts concluded that the movement of illegal profits to relief

defendants related back to the filing of the original complaint.[2] Powhatan cites no contrary authority for the position that the movement of illegal profits under a contingent arrangement—which occurred here close in time to the alleged unlawful activity—is not logically tied to the illegal act itself.[3]

Third, Powhatan's invocation of the doctrine of laches is without merit. It has been the law for nearly 200 years that "laches, . . . is inapplicable when the United States brings suit in its sovereign capacity." *United States v. Moore*, 703 F. Supp. 455, 458 (E.D. Va. 1988); *see also United States v. Kirkpatrick*, 22 U.S. 720, 735 (1824) (Story, J.) ("The general principle is, that laches is not imputable to the Government; and this maxim is founded, not in the notion of extraordinary prerogative, but upon a great public policy. The government can transact its business only through its agents; and its fiscal operations are so various, and its agencies so numerous and scattered, that the utmost vigilance would not save the public from the most serious losses, if the doctrine of laches can be applied to its transactions."); *United States v. City of Greenville*, 118 F.2d 963, 966 (4th Cir. 1941) ("[I]t is well settled that the rights of the government are not affected by laches of its officers and that it is not estopped by their conduct from asserting its rights . . . .") (citations omitted); *Leonard v. Gage*, 94 F.2d 19, 25 (4th Cir.

[2] Indeed, it is the norm in cases involving fraudulent trading that the trades themselves and the distribution of the profits of those trades are two separate steps, and yet, the SEC, CFTC, and other similarly situated agencies routinely add relief defendants in these types of cases.

[3] Powhatan cites to a single case holding that an asserted claim did not relate back—a *habeas corpus* case where the court held that a criminal defendant's attempt to add an ineffective assistance of counsel claim did not sufficiently relate back to his other three previously asserted claims. *United States v. Pittman*, 209 F.3d 314, 318 (4th Cir. 2000). *Pittman* is inapposite. Here, FERC's claim against the Proposed Relief Defendants relates directly to its already asserted claim which attempts to seek the disgorgement of the proceeds of Powhatan's illicit trading.

1938) ("Laches cannot ordinarily be asserted against the public officer of the United States seeking to discharge his official duty.") (citations omitted).

Fourth, Powhatan claims that its ability to litigate this case on the merits will somehow be compromised by giving the Proposed Relief Defendants notice and the opportunity to defend against their status as such, and warns that granting the Motion to Amend will cause delay. *See* Response at 14 (claiming that adding relief defendants risks "further modification of the scheduling order, more discovery, more expense, and more delay"). FERC does not share this view, as it made clear in its opening brief. The Proposed Relief Defendants could only be ordered to pay disgorgement if Powhatan itself were found liable for disgorgement, either at summary judgment or after trial on the merits. And, courts have found that properly joined relief defendants may be ordered to make equitable disgorgement using only summary procedures. *See, e.g.*, *SEC v. Colello*, 139 F.3d 674, 677 (9th Cir.1998).

The cases Powhatan quotes in its Response for the proposition that adding relief defendants will result in full-blown discovery or complicate the merits at trial do not support its position. *SEC v. Cavanaugh*, 155 F.3d 129, 136-37 (2d Cir. 1998), upheld a preliminary injunction issued to freeze certain assets of a relief defendant who held funds derived from alleged securities fraud. The appeals court stated that the asset freeze was a permissible means of maintaining the *status quo*, that the relief defendant would have an opportunity to argue her legitimate claim to the funds, and that claim over the funds would need to be relinquished only "[i]f the SEC prevails." *Id. at 137. SEC v. Ross*, 504 F.3d 1130, 1142 (9th Cir. 2007), disapproved of a receiver's pursuit of disgorgement from a non-party who was never named as a relief defendant, not in receivership, and never served with process in the SEC's underlying

suit—a situation that would not obtain here if FERC's motion to amend were granted.[4] Elsewhere in *Ross*, however, the Ninth Circuit noted that it approved of "a truncated form of process vis-à-vis 'a non-party depository as a nominal defendant to effect full relief in the marshaling of assets that are the fruit of the underlying fraud.'" *Id.* at 1141 (quoting *SEC v. Colello*, 139 F.3d 674, 677 (9th Cir. 1998)). FERC seeks an analogous path here: first establishing Powhatan's liability on the merits to disgorge ill-gotten funds derived from manipulative trading, and, second, pursuing the relief defendants—using post-trial summary procedures, if necessary—for amounts they personally derived from this trading under the redemption agreements signed by them.

* * * * *

FERC does not seek to add the Proposed Relief Defendants as a form of "impermissible pre-trial attachment," Response at 6, or for any illegitimate purpose. Instead, it seeks to enforce in equity what Powhatan and the Proposed Relief Defendants recognized a long time ago but which FERC learned only this year: that Powhatan distributed the proceeds of its illegal trading in this case to the Proposed Relief Defendants on a contingent basis, and that those distributions remained "at risk." The Court should recognize this fact as well, exercise its inherent equitable powers, and grant FERC's request to add the Proposed Relief Defendants to the Complaint.

[4] More particularly, the receiver in *Ross* argued such attachment was permissible based, in part, on an allegation that the employees independently violated the securities laws. *Ross*, 504 F.3d at 1144. FERC makes no allegation here that the Proposed Relief Defendants independently violated the Federal Power Act or the Anti-Manipulation Rule.

Respectfully Submitted,

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Dated: December 22, 2021

CERTIFICATE OF SERVICE

I hereby certify that on December 22, 2021, I filed the foregoing motion with the Clerk's Office, using the CM/ECF system, which will send a notification of such filing to counsel of record in this matter.

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