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

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

PLAINTIFF FEDERAL ENERGY REGULATORY COMMISSION'S
MEMORANDUM IN SUPPORT OF MOTION FOR A DEFAULT JUDGMENT

Plaintiff Federal Energy Regulatory Commission ("FERC") moves the court for a default judgment against Defendant Powhatan Energy Fund LLC ("Powhatan").[1] Following its declaration of bankruptcy (ECF No. 301), the Trustee for the Estate of Powhatan (the "Trustee") has decided to no longer defend this litigation. Based on that representation and upon FERC's request, the clerk entered a default on March 7, 2023. ECF No. 320. Pursuant to Federal Rule of Civil Procedure 55(b)(2), FERC therefore moves for a default judgment affirming the Commission's Order Assessing Penalties against Powhatan. *See* Ex. 1 to ECF 1 (Order Assessing Penalties).

[1] Consistent with Fed. R. Civ. P. 55(b)(2), FERC served written notice of its intent to move for a default judgment on Powhatan and the Trustee on February 16, 2023, more than seven days prior to the filing of this motion.

PROCEDURAL BACKGROUND

This case has a lengthy background, including proceedings in this Court, an administrative proceeding at FERC, an interlocutory appeal to the United States Court of Appeals for the Fourth Circuit, and a bankruptcy proceeding. Accordingly, FERC summarizes only the procedural background germane to the instant motion.

FERC filed its original Complaint in this case on July 31, 2015. ECF No. 1. That Complaint was amended on January 29, 2018. ECF No. 93. The Complaint followed a contested and adversarial proceeding before the Commission, which resulted in an Order finding that Powhatan had violated the Federal Power Act's ("FPA") prohibition on market manipulation (16 U.S.C. § 823b) and assessing penalties and disgorgement totaling $20,265,108. *See* Ex. 1 to ECF No. 1 (Commission Order Assessing Penalties). Consistent with the requirements of the FPA, the Complaint seeks this Court's affirmance of the Commission's Order. ECF No. 1 at 29.[2]

The parties thereafter engaged in years of discovery and motion practice during which Powhatan actively defended this action. The extensive pre-trial proceedings culminated in the close of fact discovery in December 2021 and the close of expert discovery in February 2022. Following the close of expert discovery, during which Powhatan declined to conduct a deposition of FERC's expert or produce its own expert, Powhatan filed for Chapter 7 bankruptcy in the United States Bankruptcy Court for the District of Delaware. Case No. 22-10142-MFW (the "Bankruptcy Proceeding"). ECF No. 302. On February 22, 2022, the Court stayed the

[2] Under FPA section 31(d)(3)(B), 16 U.S.C. § 823b(d)(3)(B), this Court "shall have authority to review de novo the law and the facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in [p]art, such [penalty] assessment."

above-captioned litigation. ECF No. 303.

Following the closure of the claims period in the Bankruptcy Proceeding, FERC and the Trustee reached an agreement whereby: 1) the Trustee would not oppose the stay being lifted in this proceeding, 2) the Trustee would no longer defend this litigation, 3) the Trustee would not oppose or otherwise challenge the entry of a default judgment based on his failure to defend the litigation, and 4) FERC would not make any attempt to enforce or otherwise collect any judgment this Court may issue outside of its claim in the Bankruptcy Court. FERC and the Trustee entered a Stipulation to this effect on February 14, 2023, and it was accepted by the Bankruptcy Court that same day. *See* ECF No. 317 Exs. A (Stipulation) and B (Bankruptcy Court Order).

Consistent with the terms of the Stipulation, FERC moved to lift the stay in this proceeding on February 16, 2023. ECF No. 316. The Court granted FERC's motion on March 6, 2023. ECF No. 318. FERC subsequently requested an entry of default from the Clerk of this Court on March 6, 2023. ECF No. 319. The Clerk entered a default on March 7, 2023. ECF No. 320.

FACTUAL BACKGROUND

Powhatan engaged in a wash-trading like scheme to defraud electric ratepayers (*i.e.*, people who pay electric bills) in the Mid-Atlantic region of the United States. *See* First Amended Complaint at ¶¶ 61-65. Powhatan's scheme was simple— it simultaneously flowed electricity in both directions between two points on the electrical grid. *Id*. By design, these transactions cancelled out. *Id*. Powhatan engaged in these sham transactions because it learned that in certain situations the body that facilitated electricity transactions and transmission in the Mid-Atlantic, PJM Interconnection LLC ("PJM"), paid out credits that at times outweighed the

transaction fees charged by PJM. *Id*. at ¶ 52. Powhatan decided to, in the words of one of its owners, "drive a truck" through what he described as a "loophole" and made millions of dollars of fraudulent wash trades for the sole purpose of capturing these credits. *See Houlian Chen, et al.*, 149 FERC ¶ 61,261 at 27 (2014) (Enforcement Staff Report). This plan was successful. In a few short months, Powhatan made $3,465,108 from transactions that the trader making the trades on Powhatan's behalf described as "risk-free." First Amended Complaint at ¶¶ 11, 57.

ARGUMENT

Federal Rule of Civil Procedure 55 provides a two-step process for obtaining a default judgment. First, Rule 55(a) requires the clerk to enter a party's default when that party "has failed to file a responsive pleading 'or otherwise defend' the action. . . ." *Transp. Dist. Comm'n of Hampton Roads v. U.S. Workboats, Inc*., No. 2:21cv181, 2021 WL 8445262, at *2 (E.D. Va. Sept. 17, 2021) (quoting Fed. R. Civ. P. 55(a)). Second, following the entry of default by the clerk, the party not in default must move the court for a default judgment. *Id.*

After an entry of default by the clerk, well-pleaded allegations of fact are construed as admitted. *Ryan v. Homecomings Fin. Network*, 253 F.3d 778, 780 (4th Cir. 2001). The Court will then "evaluate Plaintiff's claims against the standards of Rule 12(b)(6) of the Federal Rules of Civil Procedure to ensure that the Complaint contains plausible claims upon which relief may be granted" based upon those admitted facts. *Juul Labs, Inc. v. The Unincorporated Ass'n Identified in Schedule A*, No. 18-cv-01207, 2019 WL 1512528, *3 (E.D. Va. Mar. 20, 2019)(citation omitted). To meet this standard, a complaint must set forth sufficient factual matter, accepted as true, "to state a claim to relief that is plausible on its face." *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)(quotations omitted). In determining whether allegations are plausible, the reviewing court may draw on context, judicial experience, and common sense.

Francis v. Giacomelli, 588 F.3d 186, 193 (4th Cir. 2009) (citing *Iqbal*, 556 U.S. at 679).

I. FERC Has Established Grounds for Default

The Trustee has made clear that he has no intention of continuing to defend this litigation. *See* ECF No. 317 Ex. A. There are no special circumstances here excusing this failure to defend the litigation, such as infancy, incompetence, or military service. *See JTH Tax, Inc. v. Smith*, No. CIV A. 2:06CV76, 2006 WL 1982762, at *1 (E.D. Va. June 23, 2006). Accordingly, the Clerk appropriately entered default on March 7, 2023. ECF No. 320.

II. Liability – The Well-Pleaded Allegations Establish That Powhatan Committed Market Manipulation

While this Court has never ruled on whether FERC's Complaint would survive Federal Rule of Civil Procedure 12(b)(6) scrutiny,[3] two other courts have reached that result in the context of virtually identical trading involving the same product in the same wholesale electric market. *See FERC v. City Power Mktg., LLC*, 199 F. Supp. 3d 218, 237 (D.D.C. 2016); *FERC v. Coaltrain Energy, L.P.*, 501 F. Supp. 3d 503, 543 (S.D. Ohio 2020). Both held unequivocally that if a trader intended to profit via trading like Powhatan's, that is to say if the trader made sham self-cancelling transactions for the sole or primary purpose of collecting credits from PJM, then that trading would be a violation of the FPA's prohibition on market manipulation. There is no reason for this Court to reach a different conclusion here. The well-pleaded factual allegations in FERC's amended complaint, deemed admitted as a result of Powhatan's default,

[3] Powhatan did attempt to have this case dismissed under Fed. R. Civ. Pro. 12(b)(6) in 2015. ECF No. 20. However, the Court denied that Motion without prejudice to instead focus the parties' briefing on the issue of the proper procedures for this litigation. ECF No. 44. Following the Court's Order regarding procedures for this case, Powhatan was permitted to renew its Motion to Dismiss, but instead chose to rely exclusively on statute of limitations grounds in seeking dismissal the second time. ECF No. 95.

establish that Powhatan committed market manipulation.

A. Market Manipulation Standard

Section 222 of the FPA, 16 U.S.C. § 824v, prohibits energy market manipulation. More specifically, it makes it "unlawful for any entity . . . directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers."

Consistent with the directive of FPA Section 222, FERC promulgated its Anti-Manipulation Rule in FERC Order No. 670, 114 FERC ¶ 61,047, 71 Fed. Reg. 4244-03 (2006) (codified at 18 C.F.R. § 1c.2). The FERC Anti-Manipulation Rule explains that:

> It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, (1) To use or employ any device, scheme, or artifice to defraud, (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.

18 C.F.R. § 1c.2(a). The Rule adopts a broad definition of "fraud" to mean "any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market." 114 FERC ¶ 61,047, at P 50. Lastly, the Rule requires that the violator have acted with scienter. *Id*. at P 52.

B. Powhatan's Conduct Meets fhe Requirements for Market Manipulation

Powhatan's trading meets the three elements of a violation of the FERC Anti-Manipulation Rule, and thus the FPA's Prohibition on Market Manipulation: 1) fraud,

2) scienter, and 3) conducted in connection with a jurisdictional transaction.

1. Powhatan's Trades Were Fraudulent

Wash trading, like Powhatan's, has long been prohibited in organized markets for securities, commodities, and electricity. *See, e.g.*, § 14:4. Judicial and CFTC decisions on Section 4c, 13 Commodities Reg. § 14:4 (describing that Congress viewed wash trading as "pure, unadulterated fraud" and that courts find similarly because "such trades do not reflect the forces of supply and demand and therefore may mislead market participants") (citation omitted). FERC first explicitly prohibited wash trading in its Market Behavior Rules in 2003,[4] which were then incorporated in relevant part into the current FERC Anti-Manipulation Rule. *See* Order No. 670 at P 59. FERC, like other similarly situated agencies, takes the view that wash trading is trading that "produces a virtual financial nullity because the resulting net financial position is near or equal to zero." *Wilson v. CFTC*, 322 F.3d 555, 559 (8th Cir. 2003). Powhatan's trading, where it flowed the same or similar amounts of power between the same points in opposite directions, was purposefully designed to create this type of "financial nullity."

This wash trading scheme acted as a fraud or deceit upon PJM and PJM market participants because it presented as legitimate trading and cloaked the fact that Powhatan was, instead, using up massive amounts of PJM's finite transmission to try and illicitly collect credits with sham transactions. As the *City Power* court put it, "FERC has plausibly alleged that UTC trading was allowed in the PJM market for the purpose of arbitrage, and that while City Power's transactions had the superficial appearance of arbitrage trades, they were in fact specifically designed not to serve that purpose, and instead to do nothing but rake in [credits]." *City Power*,

[4] *Investigation of Terms and Conditions of Pub. Util. Mkt.-Based Rate Authorization*, 105 FERC ¶ 61,218 (2003).

199 F. Supp. 3d at 233.[5]

This fraud resulted in demonstrable harm to PJM and other market participants. First, the pool of money that paid the credits at issue was finite. *See* Order Assessing Penalties at ¶ 98. Every penny paid out to Powhatan was a penny taken from another market participant making legitimate trades. *Id*. The reductions in these payments were substantial, depriving twenty market participants of at least $100,000 and four market participants of at least $500,000. *Id*. Second, Powhatan's trading had a detrimental effect on PJM's transmission system. *Id*. at ¶ 99. Transmission is a finite resource and was required to be reserved for each of Powhatan's trades. At the height of its scheme, the trading of Powhatan and its trader amounted to nearly 10% of all transmission in PJM, which had the effect of depriving legitimate market participants of access to transmission. *Id*.

2. Powhatan Acted with Scienter

Scienter under the FERC Anti-Manipulation Rule requires reckless, knowing, or intentional actions taken in conjunction with a fraudulent scheme, material misrepresentation, or material omission. Order No. 670, FERC Stats. & Regs. ¶ 31,202 at P 52-53. Powhatan acted with scienter here because it understood the purpose of the financial product it was trading—namely arbitrage—and instead chose to engage in the wash trading-like scheme described above. *See* Order Assessing Penalties at ¶¶ 137-140. Powhatan was at all times aware that its trader was taking steps to create trades that would result in a financial nullity. *Id*. at ¶ 138 ("I remember

[5] The term "UTC Trading" refers to the specific financial product traded by both City Power and Powhatan. City Power's scheme was identical to Powhatan's in all material respects. *See City Power*, 199 F.Supp.3d at 226. UTC trades were initially designed as a hedging product, but evolved over time into a financial product used to arbitrage price differences between two points on the electric grid. *See* Order Assessing Penalties at ¶¶ 18-20.

[Powhatan's trader] saying . . . that he was very clearly trying to eliminate that [spread], and he was going from A to B – B to A."). Internally, Powhatan was not bashful about acknowledging what it was doing, with one of Powhatan's owners encouraging the company to "drive a truck" through the "loophole" that inspired the scheme. *Houlian Chen, et al.*, 149 FERC ¶ 61,261 at 27 (2014) (Enforcement Staff Report). It is abundantly clear from the evidence reviewed by the Commission (and contained in the Administrative Record) that Powhatan believed the self-cancelling nature of trades at issue made them "risk free." First Amended Complaint at ¶¶ 11, 57.

3. Powhatan's Trades Were Jurisdictional Transactions

Powhatan's trades were unequivocally subject to FERC's jurisdiction. *See* Order Assessing Penalties at ¶¶ 144-148. The trades took place in a market directly regulated by FERC that operates subject to a FERC-approved tariff. *Id*. Moreover, the trades affected wholesale energy prices and interstate energy transmission, which are at the core of FERC's jurisdiction. *Id*. There is no credible argument that the trading was not subject to FERC's jurisdiction, and no court has found to the contrary. *See, e.g., City Power*, 199 F. Supp. 3d at 239 (finding that trading materially identical to Powhatan's was FERC jurisdictional).

III. No Further Hearing Regarding Damages or Any Other Matter Is Necessary

Upon a showing of a party's failure to defend the litigation but before entering a default judgment, "[t]he court *may* conduct hearings or make referrals—preserving any federal statutory right to a jury trial—when, to enter or effectuate judgment, it needs to: (A) conduct an accounting; (B) determine the amount of damages; (C) establish the truth of any allegation by evidence; or (D) investigate any other matter." Fed. R. Civ. P. 55(b)(2) (emphasis added). However, in appropriate circumstances, "a district court entering a default judgment may award

damages ascertainable from the pleadings without holding a hearing." *Anderson v. Found. for Advancement, Educ. & Employment of Am. Indian*s, 155 F.3d 500, 507 (4th Cir.1998) (citation omitted).

As discussed in detail above, FERC's Complaint is well-pled and relies on its 90-page Order Assessing Penalties against Powhatan. That Order was the result of a contested adversarial proceeding, during which Powhatan was given ample opportunity to present both evidence and argument on its behalf. FERC's resulting Order set out and analyzed Powhatan's arguments and evidence in detail in order to establish the truth of the allegations against Powhatan before determining that Powhatan violated the FPA's prohibition against market manipulation. *See generally* Order Assessing Penalties at ¶¶ 10 – 141. Given the extensive evidentiary support for the sum certain contained in the pleadings here, which is uncontested based on the Trustee's Stipulation, no hearing is necessary under these circumstances.

FERC's Order also conducted an accounting of Powhatan's financial gain attributable to its fraudulent scheme and explained how it determined that Powhatan should be required to disgorge $3,465,108. *Id*. at ¶ 188. FERC then explained how that amount was used to determine an appropriate penalty under FERC's Penalty Guidelines, resulting in a penalty of $16,800,000. *Id*. at ¶ 150. The Order's detail on these issues obviates the need for the Court itself to conduct any additional accounting of the penalties or disgorgement sought against Powhatan. *JTH Tax,* 2006 WL 1982762, at *2 ("If the defendant does not contest the amount pleaded in the complaint and the claim is for a sum that is certain or easily computable, the judgment can be entered for that amount without further hearing."); *see also CFTC v. Tate Street Trading, Inc*., No. 3:19-cv-00690, 2021 WL 5105031, at *5 (E.D. Va. June 1, 2021) (finding an evidentiary hearing unnecessary in entering default judgment for restitution and penalties based on sufficient

evidence of record in the CFTC's pleadings).

Lastly, FERC submits that there are no other matters warranting further hearing. After years of litigation, the Court is well aware of the parties' claims and contentions, which have been the subject of dozens of motions and pleadings. Given the depth of the Order Assessing Penalties, the breadth of the accompanying Administrative Record, and the volume of pleadings setting out the parties' positions, FERC is aware of no other issue affecting the disposition of this motion that would benefit from additional hearings.

CONCLUSION

For the above reasons, FERC respectfully requests that the Court enter a default judgment affirming FERC's Order Assessing Penalties, 151 FERC ¶ 61,179, by finding that Powhatan violated the FPA's prohibition on market manipulation and assessing damages in the amounts of $3,465,108 in disgorgement and $16,800,000 in civil penalties.

Respectfully submitted,

Dated: March 7, 2023

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CERTIFICATE OF SERVICE

I certify that on March 7, 2023, the foregoing was filed with the Court's CM/ECF system, which caused a copy to be served on counsel of record for all parties to this action.

A copy of the foregoing was also served upon the Trustee (David Carickhoff) and its counsel (Alan Root).

/s/Kevin Dinan
Kevin Dinan