IN THE 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

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

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INTRODUCTION

For five years during FERC's investigation, we laid bare fatal flaws afflicting the positions FERC enforcement staff took and FERC eventually embraced. For five years, FERC and its staff ignored much of what we said. While inefficient, that is permissible here, given FERC's role of investigating potential statutory violations and determining whether to pursue claims. Because FERC had no authority to adjudicate anything in this case, it had no statutory obligation to address our arguments.

That changed when FERC filed this civil action. FERC now must grapple with the problems afflicting the heart of its case. It has not done so. Consistent with its stance during the investigation that preceded this action, whenever the substance of an issue presents difficulties, FERC's reaction is to ignore the problem. But FERC cannot defeat our motion to dismiss by ignoring our arguments. Those arguments go to fundamental, unavoidable issues—whether this action is time-barred, whether FERC has pled a legally cognizable and particularized theory of fraud, whether FERC violates the constitutional clear notice doctrine, and whether FERC's authority to penalize "entities" authorizes it to penalize natural persons. FERC's failure to engage those issues sinks this action below the waterline of surviving our motion to dismiss.

ARGUMENT

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

As we anticipated, FERC relies primarily on the First Circuit's decision in *United States v. Meyer*, 808 F.2d 912 (1st Cir. 1987), to argue that this action is timely because there allegedly is a second five-year limitations period that began running after FERC issued its penalty assessment order. FERC fails, however, to refute our showing that after the Supreme Court's unanimous decision in *Gabelli v. Securities and Exchange Commission*, 133 S. Ct. 1216 (2013),

Meyer no longer is good law (and is not the law of this circuit in any event). Likewise, FERC cannot overcome the point that, even if *Meyer* survived *Gabelli*, it fails to support FERC's position because the FPA limits FERC's role here to the type of "prosecutorial determination" that *Meyer* deemed irrelevant to applying the limitations period in 28 U.S.C. § 2462.

A. FERC Fails to Refute That Gabelli *Overruled* Meyer

Meyer recognized two limitations periods—one period running from the alleged violation to the initiation of an administrative adjudication, and a second period running from the issuance of a final agency order until the initiation of an enforcement action in federal district court. *Meyer* thus would enlarge, indefinitely, the five-year limitations period that *Gabelli* has since held must provide a fixed date, five years from the conduct at issue, after which the government's claim for civil penalties is time-barred. *Meyer* therefore does not survive *Gabelli*. FERC never answers this fundamental argument, which is fatal to its position.

Under FERC's theory, the civil penalty claim in this case accrued or July 29, 2015, 60 days after the penalty assessment order was issued. Opp. 7. If FERC were correct, that would mean it would have another five years from that date to file this action for civil penalties—or until July 29, 2020—roughly *ten years* after the conduct at issue. And that time period could stretch even further—indefinitely—because there would be no time limitation on how long FERC might take between (1) its alleged satisfaction of the first five-year limitations period (by initiating an administrative process), and (2) its issuance of a penalty assessment order (which, after the passage of 60 days, allegedly begins the second five-year limitation period. A statute of limitations generally ranging somewhere between ten years and infinity cannot be squared with *Gabelli's* requirement for a "fixed date when exposure to the specified Government enforcement efforts ends." *Gabelli*, 133 S. Ct. at 1221.

FERC tries to distinguish *Gabelli* on the ground that the underlying statute alleged to have been violated in that case (the Investment Advisers Act) authorized the court, not the agency, to impose penalties. As explained below, however, under the FPA provision that applies here, FPA § 31(d)(3), it is this court—not FERC—that adjudicates alleged penalty liability and ultimately has the authority to impose a civil penalty. FERC therefore misses the mark in purporting to distinguish between the penalty assessment schemes in the Investment Advisors Act and the FPA.

That conclusion is underscored by a key concession in FERC's complaint.[1] FERC acknowledges that this court possesses the authority to fully adjudicate any and all issues presented in the complaint. Specifically, FERC states: "[s]hould the Court determine . . . that its review of the Order requires a trial on any issues, the Commission, pursuant to Rule 38 of the Federal Rules of Civil Procedure, demands a trial by jury on all issues triable as such." Complaint ¶ 108.

The defendants disagree that the statute silently confers on the court the discretion to conduct this action in any fashion it sees fit—which is the practical implication of FERC's position. Under the Federal Rules of Civil Procedure, there is one form of action—the civil action. *See* Fed. R. Civ. P. 2. Where, as here, Congress has not expressly directed a more

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[1] FERC calls its complaint a "petition." But FPA § 31(d)(3) does not use the word "petition." In *Securities and Exchange Commission v. McCarthy*, 322 F.3d 650 (9th Cir. 2003) ("*McCarthy*"), the Ninth Circuit held that because the statute in that case called for the SEC to file an "application," and not an "action," the statute contemplated a summary proceeding rather than a plenary adjudication under the Federal Rules of Civil Procedure. *Id.* at 655. This demonstrates that the words Congress uses in a statute matter. FPA § 31(d)(3), in contrast to the statute construed in *McCarthy*, calls for FERC to file an "action." 16 U.S.C. § 823b(d)(3)(b). There thus is no statutory basis for FERC to style its opening pleading here as a "petition," rather than a complaint; nor is there any statutory basis for FERC to refer to the defendants as "respondents."

limited proceeding, an action involves "the full array of legal, procedural, and evidentiary rules governing the process by which a court adjudicates the merits of a dispute." *McCarthy*, 322 F.3d at 657; *Califano v. Yamasaki*, 442 U.S. 682, 700 (1979) (Federal Rules of Civil Procedure apply absent a "direct expression by Congress of its intent to depart from the usual course of trying 'all suits of a civil nature' under the Rules established for that purpose.").

In any event, FERC is correct that FPA § 31(d)(3) authorizes the court to hold a trial (as opposed to conducting an appellate-style review). And FERC's statute of limitations argument does not survive that concession, because it means that the concerns expressed in *Gabelli* regarding fading memories and lost evidence apply with full force. *See Gabelli*, 133 S. Ct. at 1221 (quoting *R.R. Telegraphers v. Ry. Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944)).

B. Meyer *Does Not Apply Because the FPA Limits FERC to a Prosecutorial Role*

Assuming *Meyer* still is good law, it does not apply here because FPA § 31(d)(3) does not authorize—let alone require—an administrative adjudication of civil penalty liability.[2]

1. The Statutory Directive for FERC to "Promptly Assess" a Penalty Does Not Authorize FERC to Adjudicate or Determine a Party's Liability

FERC claims that the statutory requirement for the agency to "promptly assess [a] penalty, by order, after the date of the receipt of [a party's district court election]" means that FERC has implied authority to craft procedures to implement that directive, including the extra-statutory "adversarial administrative proceeding" it purports to have conducted here. Opp. n.8. FERC is mistaken.

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[2] FERC curiously argues that addressing the court's role in the civil penalty assessment established by FPA § 31(d)(3) is a "premature" issue, "not properly before the Court" in a motion to dismiss for failure to state a claim. Opp. 29. FERC cannot at the same time seek to invoke the second limitations period recognized in *Meyer* while contending it is premature to address the respective roles of the agency and the court.

First, under the option for administrative adjudication set forth in FPA § 31(d)(2)—which is *not* the option the defendants elected—FERC is expressly authorized to make "a *determination of violation* . . . on the record after an opportunity for an agency hearing." 16 U.S.C. § 823b(d)(2) (emphasis added). In contrast, under the option for a federal district court action—the option the defendants *did* elect—FERC is *not* authorized to make any comparable determination. Instead, the statute expressly requires FERC to "promptly assess such penalty, by order, after the date of the receipt of the [district court election] notice." *Id*. § 823b(d)(3)(A). FERC has characterized this as requiring an "immediate" assessment order. *Procedures for the Assessment of Civil Penalties Under Sec. 31 of the Fed. Power Act*, Order No. 502, FERC Stats. & Regs.¶ 30,828 at P II.5.1.b (1988). That statutory mandate contradicts FERC's claim that it is authorized to conduct an "adversarial administrative proceeding," Opp. 4, and create an "enormous administrative record," *id*. at 2, following a party's election of a federal district court action. If Congress had intended to give FERC the discretion it claims, Congress would not have mandated a "prompt[]" assessment following FERC's receipt of a party's district court election notice.

Second, as used in FPA § 31(d)(3)(A), the word "assess" does not—as FERC argues—imply that FERC is authorized to "impose" a civil penalty. The definition of the word "assess" that FERC quotes in its brief demonstrates this point. Opp. n.5. The first meaning set forth in the quoted definition of "assess" is "to fix the amount of (a tax, fine, etc.)." *Id*. That is all FERC was authorized to do here—fix the amount of the penalty it seeks in this court.

FERC's position also contradicts the statutory context surrounding the directive in FPA § 31(d)(3) for FERC to "assess [a] penalty, by order." Under FPA § 31(d)'s option for an administrative adjudication, after FERC issues a final order—one that has not been appealed or has been affirmed on appeal—the result is a "final assessment order." 16 U.S.C. § 823b(d)(5). And that order is subject to a federal district court collection action, where the "validity and

appropriateness of such final assessment order . . . shall not be subject to review." *Id.* In contrast, under the district court option, the statute recognizes the end result to be a federal district court "judgment," that likewise can be the subject of a recovery action. *Id*. FPA § 31(d) thus distinguishes between (a) an order that merely fixes the penalty FERC seeks to collect in a federal district court action and (b) a "final assessment order" that is the end product of a statutorily-authorized administrative adjudication, with the opportunity for an aggrieved party to seek judicial review. The assessment order FERC issued against the defendants on May 29, 2015 is the former, not the latter.

2. The Federal District Court Action Under FPA Section 31(d)(3) Is Not an Appellate-Style Review

Attempting to bring this case within the second limitations period discussed in *Meyer*, FERC states that "the role of the district court in proceedings under paragraph (d)(3) of FPA § 31 is analogous to the role of the Court of Appeals under (d)(2)"—meaning traditional appellate court review of a final agency order. Opp. n.6. That analogy fails on several levels.

First, an appeal of an agency order is the process by which an aggrieved party challenges a final decision of the agency. *See, e.g*., 16 U.S.C. § 825*l*(b). If an aggrieved party does not exercise the right to seek judicial review, the order in question becomes final and enforceable. *See generally id*. That is not the case here. The FPA does not authorize FERC to adjudicate or determine the defendants' liability. Nor does it contemplate that FERC issue a binding order that the defendants could appeal. Complaint, Ex. 1 ¶ 193.

Second, the fact that this is not an appeal, and that the court is not limited to review of a so-called "administrative record," is made plain by the fact that FPA § 31(d)(3)—the option for a federal district court action—does not include any reference whatsoever to an administrative record. In contrast, if a party elects an administrative adjudication before a FERC administrative

law judge under § 31(d)(2), the statute requires FERC to make a "determination of violation . . . *on the record* after an opportunity for an agency hearing pursuant to Section 554 of Title 5 before an administrative law judge." 16 U.S.C. § 823b(d)(2) (emphasis added).

Third, FERC errs in focusing on the statute's use of the word "review" as a basis for claiming that the court's role here is limited to an appellate-style review. *See, e.g.*, Opp. 2. It is well-established that, when construing statutory language, courts must avoid focusing on isolated words. *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015). Here the FPA uses the term "review de novo" to dictate the standard of review, not the scope of the proceeding.

In *United States v. First City National Bank of Houston*, 386 U.S. 361 (1967), the Supreme Court construed a statute containing "review de novo" language virtually identical to the FPA and expressly rejected the notion that the term "review" indicates the district court action is something less than a plenary adjudication: "It is argued that the use of the word 'review' rather than 'trial' indicates a more limited scope to judicial action. The words 'review' and 'trial' might conceivably be used interchangeably. The critical words seem to us to be 'de novo' and 'issues presented.'" *Id*. at 368. The Court reached this result, in part, because the prior agency process was not a traditional adjudication: "the Comptroller's action is informal, no hearings in the customary sense having been held . . . and none being required by Congress in the 1966 Act." *Id*. In light of the statutory scheme, the Court concluded that interpreting the phrase "review de novo" to preclude a trial would require one "to assume that Congress made a revolutionary innovation by making administrative action well nigh conclusive, even though no hearing had been held and no record in the customary sense created." *Id*. The Court instead held that the words "review de novo the issues presented" dictated the standard (but not the scope) of review: "[Those words] mean to us that the court should make an independent determination of the issues." *Id*.; *see also Stone v. Instrumentation Laboratory Co.*, 591 F.3d 239, 246 (4th Cir.

2009) ("[B]y definition, *de novo* review entails consideration of an issue as if it had not been decided previously.") (citations and quotations omitted).

The same conclusion applies here, where FPA § 31(d)(3) requires the court to review "the law and the facts involved," 16 U.S.C. § 823b(d)(3)(A)—not to review a FERC order, or a so-called administrative record that is not even mentioned in the relevant statutory provision. This is not an appeal and the court's role is not limited to the review function FERC asserts.

Finally, FERC asserts that its show cause order tolled the statute of limitations because "if the order to show cause . . . is *not* the event that tolls the statute of limitations, there is no subsequent common event that would toll the statute under both [procedural paths]"—the administrative path and the district court path—provided for in FPA § 31(d). Opp. 9. That is faulty logic.[3] Because the statute provides for two *different procedural options*, it makes sense that the "action, suit or proceeding" § 2462 requires to be "commenced within five years" would be a *different procedural event* depending on which of those options is elected.[4]

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[3] FERC states, incorrectly, that the court in *FERC v. Barclays Bank PLC*, No. 2:13-CV-2093-TLN-DAD, 2015 WL 2448686 (E.D. Cal. May 20, 2015), "found that it is the Order to Show Cause that must be issued within five years of the underlying violation." Opp. n.2. That court noted FERC's "position" on this issue, but did not adopt it. *Barclays*, 2015 WL 2448686, at *8. Instead, the court held that because FERC and the defendants had entered into an agreement to toll the statute of limitations, FERC's claim for civil penalties was timely regardless whether the court looked to the "[show cause order], the Order Assessing Penalties, or the Petition [initiating the district court action]" as commencing the required proceeding under § 2462. *Id*. In addition, the court expressly rejected *Meyer*'s holding that a "claim accrues for the purposes of 28 U.S.C. § 2462 only when the administrative proceeding has resulted in a final determination." *Id*. at *7. Instead, the court followed "the plain directive from *Gabelli* . . . that the clock starts to tick when the underlying violations occurred." *Id*. In light of the court's conclusion that the parties' tolling agreement expanded the limitations period, however, the court's discussion of *Meyer* is dicta.

[4] FERC's regulations are consistent with the two procedural tracks in the statute. Under 18 C.F.R. § 1b.19, enforcement staff is required to notify the subject of an investigation, and to allow an opportunity to respond, if enforcement is planning to recommend that FERC seek a civil penalty by making that party either "the subject of a proceeding governed by [18 C.F.R. *(cont'd)*

For all of these reasons, *Meyer* does not save the stale claims FERC is asserting here.[5]

C. FERC's Claim for Disgorgement Is Likewise Time-Barred

As we explained in our memorandum supporting the motion to dismiss, the state of the law on whether § 2462 bars claims for disgorgement is unsettled. *See Gabelli*, 133 S. Ct. at n.2. We submit that the court in *Securities and Exchange Commission v. Graham*, 21 F. Supp. 3d 1300 (S.D. Fla. 2014), correctly concluded both that (1) disgorgement is a forfeiture expressly subject to § 2462, and (2) the bedrock principles articulated in *Gabelli* apply to claims for disgorgement with the same force they apply to claims for civil penalties.

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

FERC offers three arguments in defense of its fraud claim: (a) it has "broad" and "flexible" anti-manipulation authority and thus need not envision and specifically prohibit

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Part 385]," or "a defendant in a civil action." 18 C.F.R. § 1b.19. If a party elects an administrative hearing under FPA § 31(d)(2), Part 385 sets forth the governing procedural rules and it is the FERC order directing a hearing that commences the adjudicatory process. On the other hand, if a party elects the procedures of FPA § 31(d)(3), FERC must initiate a civil action in federal district court and that is the procedural event that satisfies the limitations period under § 2462.

[5] With no legal support and almost no explanation, FERC makes a related tolling claim, asserting that the statute of limitations "must be tolled for at least [90 days]" because "the statute requires no fewer than 90 days' worth of administrative proceeding." Opp. n.8. FERC apparently is calculating 90 days based on the 30 days for the entity facing a potential penalty to elect between an administrative and a judicial assessment process, plus the 60 days (under the judicial path) during which a party can either pay the penalty or try to "compromise" it with FERC prior to the initiation of a federal district court penalty action. *See* 16 U.S.C. §§ 823b(d)(3)(b) & 823b(d)(4). But neither of these things is an "administrative proceeding." In any case, FERC provides no authority to explain why either of those periods should toll the statute of limitations. The Fifth Circuit has expressly rejected a similar argument. *United States v. Core Labs., Inc.*, 759 F.2d 480, 484 (5th Cir. 1985); *see also Gabelli*, 133 S. Ct. at 1224 ("the cases in which 'a statute of limitation may be suspended by causes not mentioned in the statute itself ... are very limited in character, and are to be admitted with great caution; otherwise the court would make the law instead of administering it.'" (quoting *Amy v. Watertown (No. 2)*, 130 U.S. 320, 324 (1889)); *Federal Election Comm'n v. Nat'l Republican Senatorial Comm.*, 877 F. Supp. 15 (D.D.C. 1995) (FEC investigation into potential violations of Federal Election Campaign Act did not toll running of five-year limitations period).

objectionable trading in advance, (b) the trades at issue were wash trades, and (c) the trades at issue were "similar" to an Enron trading strategy called "Death Star." FERC's assertions on the first two points ignore our arguments and do not survive analysis. The Death Star claim also is groundless: the critical feature of "Death Star" is missing here—a point we made before the agency that FERC continues to ignore. And FERC's opposition says nothing whatsoever in defense of its assertions in complaint paragraph 81, which stands undefended and undefendable.

A. FERC Has Not Pled a Legally Cognizable Theory of Fraud

1. FERC's Pleas for "Broad" and "Flexible" Authority Run Aground on the Statute

Unable to offer any legally cognizable, properly pled theory of fraud, FERC spends much of its opposition claiming it has "broad" and "flexible" authority "to prohibit fraud and other forms of impropriety in the energy trading markets." Opp. 17. It is impossible, we repeatedly are told, to anticipate, and expressly prohibit, in advance, all of the methods by which someone might manipulate the energy markets. *Id.* at 17-22. FERC cannot, we are told, be left fighting yesterday's battles; it must instead fight tomorrow's, and so it needs broad and flexible anti-manipulation authority. *Id.*

This is a sideshow. Congress has authorized FERC to prohibit *fraud-based* market manipulation in FPA § 222, 16 U.S.C. § 824v. That statute follows the precise terms that the Securities and Exchange Commission administers under § 10(b) of the Securities Exchange Act, 16 U.S.C. § 824v (with one exception discussed below: the substitution of "entity" for "person"). As the Supreme Court has emphasized, § 10(b)—and thus also FPA § 222—"is aptly described as a catchall provision, but what it catches must be fraud." *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980).

That inescapably means FERC can pursue market manipulation claims *only* if it can properly plead, and eventually prove, fraud. It cannot escape the strictures imposed by Congress, which expressly require fraud as an irreducible element.

FERC therefore does not have authority to pursue market manipulation claims against "other forms of impropriety in the energy trading markets" that do not involve fraud. Opp. 17. FPA § 222 is not a roving mandate for FERC to allege market manipulation against any trading it ultimately decides, after the fact, it does not like. Whatever FERC means by "other forms of impropriety" that are not fraudulent, it must prohibit them in advance.

That still leaves FERC with authority both broad and flexible. It can adopt whatever market rules it wants (and can defend on judicial review). But it must do so in advance. Where it fails to do so—and where it cannot properly plead, and ultimately prove, fraud—it can impose whatever prohibitions it wants (and can defend) *going forward*. But it cannot apply those prohibitions retroactively.

2. FERC's "Impairing a Well-Functioning Market" Argument Cannot Evade the Need to Properly Plead, and Ultimately Prove, Fraud

In our memorandum, we explained that FERC has not defended, and cannot defend, its effort to expand the meaning of fraud to include conduct it thinks "impairs a well-functioning market." In response, FERC offers no analysis of the statute's actual language. It also offers no defense of its patent misreading of the Supreme Court's decision in *Dennis v. United States*, 384 U.S. 855, 861 (1966), which was the (misplaced) source of its "impairing a well-functioning market" claim. Instead, unable to respond on the merits, FERC simply asks for "significant deference" to "its anti-manipulation authority." Opp. 22. That plea makes no sense.

As a threshold matter, Congress has specified that this court "review de novo the law and the facts involved." 16 U.S.C. § 824b(d)(3)(B). Congress therefore has dictated that this court

give no deference to FERC's legal arguments. One of the cases FERC cites confirms this, stating that Congress can "direct the court not to pay deference to the agency's views." *United States v. Haggar Apparel Co.*, 526 U.S. 380, 391 (1999). FERC claims that case stands for the proposition that courts give deference under *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), when reviewing legal issues de novo. But the Court in *Haggar* merely found that the particular statute at issue—which did not say anything about de novo review—did not include any "directive" for "the court not to pay deference to the agency's views." *Id.* Here the statute directs the opposite result.

In any event, even if we set aside that statutory bar, FERC has not even attempted to satisfy the threshold requirements for *Chevron* deference. To get deference under that doctrine, an agency must (1) show, using traditional canons of statutory interpretation, that the statute is ambiguous, and (2) establish, under those canons, that its interpretation is reasonable. *Hui Zheng v. Holder*, 562 F.3d 647, 651 (4th Cir. 2009).[6] FERC has not even attempted to accomplish those two tasks—not in the complaint, not in the penalty assessment order, and not in any other order it has ever issued. It has never sought to root its amorphous view of fraud in the language of the statute. It has never argued—much less established—that the statute is ambiguous. And it has never explained why its interpretation is reasonable. While *Chevron* does not apply by statute, even if it did its prerequisites would not be met.[7]

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[6] FERC cites this case along with *Haggar* for the proposition that courts defer to agency statutory interpretations when reviewing de novo. But like *Haggar*, *Hui Zheng* did not involve a statutory directive for courts to engage in de novo review.

[7] For the same reasons, FERC errs in seeking deference under *Auer v. Robbins*, 519 U.S. 452, 461 (1997). Opp. 22. FERC's anti-manipulation regulation simply repeats the § 10(b) language in FPA § 222. *See* 18 C.F.R. § 1c.2. FERC's statements in the preamble to that regulation do not even purport to interpret the language of the statute or the regulation. FERC *(cont'd)*

3. FERC's Has Not, and Cannot, Fit the Disputed Trading Into Any Legally Cognizable Definition of Wash Trading

In our memorandum, we made the undeniably correct observation that because the disputed trades made large sums of money, they cannot, by definition, be wash trades. Memorandum at 24-25. FERC offers no response. Instead, it offers misdirection. Without ever expressly saying so, FERC's wash trade assertion assumes away the existence of both loss credits and transaction costs. It then asserts that the remaining component of each of the "paired" trades—a component FERC sometimes describes as reflect price spreads—is precisely offset. But FERC cites no precedent anywhere for finding transactions to be wash trades where only one of several components that dictate profit and loss for each trade ultimately offset.

As we explained in our memorandum, when the price-spread components offset, the trades still involved economic risk. The fixed transaction costs—mainly transmission charges—might be more or less than the floating loss credit. And there was an exchange of beneficial ownership. The defendants paid transmission and other transaction costs to PJM, and PJM paid loss credits to the defendants. There is nothing "wash-like"—or fraudulent in any way—about this. And FERC offers no response.

4. FERC's Belated Invocation of "Death Star" Misses the Mark

FERC fails to rescue its case by reviving its prior assertion that the disputed trades were like Enron's "Death Star" strategy. That assertion appears nowhere in the complaint, which is itself fatal.[8] In any event, FERC ignores a critical distinction (among many).

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points to nothing ambiguous in either text. And FERC does not explain, here or anywhere else, why its position, which floats untethered to any textual analysis, is reasonable.

[8] Federal Rule of Civil Procedure 8 requires a pleading to contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(1). Although a "written instrument" may be made part of a pleading as an exhibit, Fed. R. Civ. P.
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Under the "Death Star" strategy, the market operator offered to pay companies for physically transmitting power in a fashion that "relieved congestion." Enron physically transmitted power in a way that qualified for these payments, but undertook other actions (transmitting power in other directions) that actually nullified any "congestion relief." So Enron took action to remove the basis for receiving those payments in the first place. Complaint, Ex. 2, App. A at 47-48 ("The effect of these schemes was to deceive the California ISO into awarding the traders congestion relief payments for trades that did not relieve congestion.").

Here the defendants fulfilled the one and only requirement for receiving loss credits: they paid for transmission. And they never took any action to rescind those payments. None of that is in dispute here. While the paired trades, viewed after the fact, involved offsetting price-spread risks, FERC had never previously said there was anything wrong with that. In fact, as we noted in our memorandum, the original purpose for up-to congestion trades was to offset precisely the same price-spread risk that FERC now claims cannot be offset without committing fraud. FERC offers no response.

In any event, FERC's prior decisions about "Death Star" did not seek to apply the Commission's current fraud-based anti-manipulation authority, which did not then exist. Whatever one might say about whether the "Death Star" strategy was fraudulent, FERC's

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10(c), that does not alter the requirements of Rule 8. Here FERC asserts that its claim is set forth in the penalty assessment order attached to its complaint, rather than in the pleading itself. That does not comport with the Rule 8 or Rule 10 because the assessment order plainly does not set forth a "short and plain statement" of FERC's claim. Are the defendants expected to admit or deny FERC's characterizations of their position in the order? Are the defendants expected to admit or deny the discussions of case law? What about the statements describing FERC's conclusions? None of that would make any sense, and underscores why the Federal Rules require the complaint to contain a short and plain statement of the claim for relief—one that can be tested under Rule 12(b)(6) and be answered with appropriate admissions or denials.

invocation of that strategy here does not remove the need to plead, and ultimately prove, fraud. And FERC points to nothing here that sounds in any legally cognizable theory of fraud.

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It is telling that FERC places virtually all of its misplaced legal arguments about fraud in the clear notice section of its brief. FERC seems to imply that it can unilaterally expand its anti-manipulation authority beyond statutory bounds simply by announcing that expansion ahead of time. To articulate that argument is to defeat it. FERC is limited by statute. It cannot bootstrap beyond express limits on its statutory authority by claiming it did so in advance.

B. FERC Has Not Pled Fraud with Particularity

1. FERC Fails to Fill the Gaps in Its Complaint by Pointing to "Context"

FERC's main focus in rebutting our position on this issue is to complain that by focusing on the particular paragraphs of the complaint that purport to allege fraud, we have ignored the "context of the entire Petition." Opp. 13. But with one exception (the "Death Star" argument discussed above), FERC points to nothing specific residing elsewhere in the Petition, or in any of its attachments, that might rescue its position. Simply counting the total number of words, or pages, or footnotes, in these documents—as FERC's opposition does (at 14)—neither remedies the fatal legal flaws in FERC's case nor remedies FERC's failure to plead fraud with particularity. FERC's generalized complaints about "context" actually underscore the lack of specificity in its claims.

2. FERC Still Lacks the "What, When, Where and How" of Fraud

FERC purports to offer particularity about its fraud claims, explaining the time and place where the disputed trades occurred. Opp. 15-16. It purports to offer a high-level description of the trades, *id*. at 16, while still declining to offer specifics about even one of them. But on the most critical shortcoming—explaining, with particularity, what was fraudulent, who was

deceived, and how—FERC's position still rings hollow. We are told that the disputed trades were wash trades and resemble "Death Star," but, as shown above, those allegations evaporate upon analysis. And FERC has abandoned any effort to defend the nonsensical allegations in paragraph 81 of the complaint.[9]

III. FERC'S CASE VIOLATES THE CLEAR NOTICE DOCTRINE

As we explained in our memorandum (as did Powhatan), it was not only predictable, but actually predicted—by FERC (and others)—that traders would respond to the incentives presented by the payment of loss credits. As FERC observed, traders could engage in transactions "simply to increase marginal line loss payments." *Black Oak Energy, LLC v. PJM Interconnection, L.L.C.*, 125 FERC ¶ 61,042 at P 43 (2008).

Powhatan gives a more extensive response in its brief. We agree with and adopt those arguments. In addition, we note that although FERC discusses the *Black Oak* cases for several pages in opposing our memorandum, it consistently attributes reasoning to those orders without any citation. That is because the reasoning FERC now offers is not actually in those orders.

For example, FERC now speaks of two proposals, one "broad" and one "much narrower," for distributing loss credits. Opp. at 24-25. But the orders never say that. FERC says that the prospect of traders trading simply to collect loss credits was "a key reason" FERC rejected the so-called broad proposal. *Id.* at 24. But the orders never say that. FERC now says that the "narrower proposal would avoid the 'perverse incentive' problem with the broad

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[9] There FERC alleged that the disputed trades "falsely appeared to PJM as legitimate … trades." Complaint ¶ 81. As we pointed out in our motion, there never was any rule about some up-to congestion trades being "legitimate" and others not. As we also pointed out, "FERC cannot state a claim for fraud by alleging that the defendants somehow concealed their failure to comply with requirements that never existed to begin with." Memorandum at 19. FERC has no response.

proposal." *Id.* at 25. But the orders never say that.[10] FERC now says it relied on statements by some parties that traders would not trade simply to obtain loss credits. *Id.* But the orders never say that.

Finally, FERC says that it "has at all times been against the abusive trading Respondents engaged in and Respondents cannot point to any Commission statement in the *Black Oak* orders or anywhere else that suggests it changed its position on such a fundamental issue." Opp. 26. That mischaracterizes what FERC said and what we argued. We have never argued that FERC changed its position on what FERC now calls the "fundamental issue" of traders trading simply to obtain loss credits. Our point is that FERC never took the position that such trading was fraudulent in the first place. Instead, it predicted that paying loss credits would create incentives leading to the same outcome it now labels fraudulent. Then it ordered PJM to pay those loss credits without ever cautioning traders not to trade with the goal of collecting them.

There was no clear notice of FERC's views about what it now calls a fundamental issue. While FERC strives to create confusion about what its *Black Oak* orders actually say, that underscores its failure to give clear notice in advance. FERC can change rules on a going-forward basis. It did that here. But it cannot remedy its failure to give prior clear notice to the defendants. And that failure is fatal to its proposal to impose civil penalties in this case.

IV. FERC LACKS AUTHORITY TO PENALIZE DR. CHEN

FERC fails to rebut the argument that FPA § 222 does not authorize claims against natural persons. FPA § 222, passed as part of the Energy Policy Act of 2005, was based directly upon the Security Exchange Act of 1934 ("Securities Act"), 15 U.S.C. § 78j. The operative language of the two statutes is identical, with one single—but critical—exception: the target of

[10] In fact, as Powhatan points out (Rebuttal Br. at 2-4), enforcement staff itself previously said the opposite.

the legislation. While the Securities Act makes it illegal for any "person" to commit market manipulation, Congress specifically and narrowly re-wrote the statutory language to make it illegal under FPA § 222 for any "entity" to commit market manipulation.

It is well-established that when Congress amends a statute, courts should presume that Congress "intends its amendment to have real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995); *see also Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 174 (2009) ("When Congress amends one statutory provision but not another, it is presumed to have acted intentionally."). And the Fourth Circuit has consistently held that "[w]hen the wording of an amended statute differs in substance from the wording of the statute prior to amendment, we can only conclude that Congress intended the amended statute to have a different meaning." *Nalley v. Nalley*, 53 F.3d 649, 652 (4th Cir. 1995); *see also Uptagrafft v. United States*, 315 F.2d 200, 204 (4th Cir. 1963) ("We should not and do not suppose that Congress intended to enact unnecessary statutory amendments."); *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 975 (4th Cir. 1993) ("[W]e presume that language added by amendment was not mere surplusage.").

FERC cites no contrary authority. Nor can it, because this principle is part of the bedrock of statutory interpretation. Instead, FERC seeks to cast doubt on our interpretation of FPA § 222 by citing a district court case from the Ninth Circuit, *Barclays*, 2015 WL 2448686 at *20-21. But that case did not address Congress's substitution of the word "entity" for the word "person," or the canon of construction that makes that dispositive. And FERC offers no alternative interpretation that can pass muster under Supreme Court or Fourth Circuit precedent. Under FERC's flawed reading, there is absolutely no difference between the "person" of the Securities Act and the "entity" of FPA § 222. And that cannot be correct. Given the court's obligation to

reject reading amendments as mere surplusage, FERC's interpretation is in fact the only reading foreclosed by black letter law.[11]

CONCLUSION

For these reasons, and the reasons in our prior memorandum, we respectfully submit that FERC's complaint should be dismissed with prejudice.

Respectfully submitted,

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[11] FERC attempts to shore up its reading of the FPA with an appeal to *Chevron*, claiming that its interpretation is entitled to deference. It is not, for the reasons given above (at 12-13). In addition, the term "entity" is not as vague as FERC implies. The ordinary meaning of entity, notwithstanding a few citations to the contrary, does not include natural persons. The overwhelming weight of dictionary entries agree. *See, e.g.*, ENTITY, *Webster's Third International Dictionary* 758 (1981); ENTITY, *Random House Dictionary of the English Language* 476 (1966); ENTITY, *Mariam Webster's Collegiate Dictionary* 417 (11th ed. 2004); ENTITY, *Black's Law Dictionary* 650 (10th ed. 2014).

Even if there were ambiguity in the term "entity" that could entitle an agency to *Chevron* deference in the normal course, these circumstances are different: there is no ambiguity whatever in the fact that Congress amended the law to replace the term "person" with "entity" and black letter law demands that the two words cannot be interpreted to have the same meaning. *Chevron* does not extend so far.

CERTIFICATE OF SERVICE

I hereby certify that on November 5, 2015, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system, which shall send notification of such filing to counsel receiving notices in this matter, including the following counsel of record:

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