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Federal District Court in Virginia Latest to Rule Against FERC on De Novo Review

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FERC was again rebuked by a federal district court for its position in a market enforcement case, with a ruling that sided with Powhatan Energy Fund LLC in the company's legal challenge to FERC's assessment of nearly $35 million in penalties.

The ruling from the U.S. District Court for the Eastern District of Virginia (*FERC v. Powhatan*, Civil Action No. 3:15cv452) marks the sixth time that FERC's position on what constitutes *de novo* review under the Federal Power Act (FPA) has been rejected, meaning Powhatan and the officers involved will be afforded a day in court to defend themselves. Those offices include Alan Chen, lead advisor at Powhatan, who also controlled two trading funds – HEEP Fund Inc. and CU Fund Inc. -- alleged to have engaged in market manipulation in PJM Interconnection.

Kevin Gates, vice president of a managing member at Powhatan, addressed the lengthy legal proceeding and the prospects for victory in court. With the change in posture for the legal review by a trial, instead of a court adopting the administrative record that had been put together by FERC without a meaningful defense from Powhatan, "we are assumed to have acted lawfully and the burden is on FERC to prove otherwise. We will get discovery rights and intend to defend ourselves vigorously," Gates said in an emailed update on the proceeding.

Gates labeled it a travesty that is has taken more than seven years to litigate the case (IN15-3), following initial allegations in 2010 about fraudulent energy trading involving transmission credits in PJM and a 5/29/15 order assessing civil penalties and disgorgement of unjust profits. Because Powhatan and the respondents did not pay the penalties, FERC filed for action with the district court, which prompted the legal interpretation for review.

Powhatan has been aggressive in defending itself and challenging the position of FERC staff in the Office of Enforcement. Among the numerous legal filings in the district court was an amicus brief from 10

professors of administrative law who registered concerns with FERC's legal position to try and limit the scope of *de novo* judicial review under the FPA.[1]

In the position struck down in the Eastern District of Virginia and elsewhere, FERC asserted that a full-blown adjudicatory process in court is not warranted on top of the administrative record the Commission typically compiles in a penalty proceeding. FERC has maintained that under the statute, when a party fails to pay a penalty within 60 days, the court's role is to review the evidence gathered by the Commission and not conduct a full trial.

In the 12/28/17, decision, Judge M. Hannah Lauck noted that no federal appeals court has rendered a decision on the matter to date, but five federal district courts (in Massachusetts, Maine, the District of Columbia, and two in California) have done so.

"The court concludes, consistent with other district courts to decide this issue, that the language and structure of the statute and principles of due process entitle Respondents to a *de novo* trial governed by the Federal Rules of Civil Procedure and the Federal Rules of Evidence," Lauck wrote.

FPA Section 31(d) governs the assessment of penalties in the *Powhatan* case, and it creates two different paths for penalties to be imposed, Lauck related. One option for the accused party is to request an evidentiary hearing before a FERC administrative law judge (ALJ), whose findings and recommendations are then subject to Commission review and a final decision. Judicial review under that option, which Powhatan did not choose, accords considerable deference to the conclusions of the agency.

The other, alternative path, which Powhatan elected, is to request FERC to promptly issue its penalty ruling on the merits, without any evidentiary hearing, whereupon the Commission must file an action in federal district court to collect the penalties. At that stage, the statute provides for a *de novo* review of the Commission's findings. In the language of FPA Section 31(d), "the court shall have the authority to review *de novo* the law and the facts involved."

FERC contended that the court has the flexibility to craft a limited but effective procedure to conduct its review, while Powhatan said it is entitled to a trial.

The language of the statute, "taken as a whole and interpreted in light of the context in which it is used makes plain that this court should conduct a trial," Lauck said. The words "review" and "trial" might conceivably be used interchangeably, but the pivotal issue involves what makes for a review of "the law and the facts involved" as written. The judge found that the differences between the two paths in the statute indicate that Congress intended the alternative path's review to involve a trial.

She also said that there is the potential for due process violations if the court did not conduct its review in the alternative path as a civil action and trial.

Compared with FERC Office of Enforcement staff, the subject of an investigation does not have discovery rights during the investigation, and the opportunity to respond to allegations is limited in form, with parties generally either reaching a settlement or contesting FERC staff conclusions. And compared with

[1] For past stories, *see*, *In Powhatan Fund Amicus Brief, Professors Protest FERC's View of "De Novo" Judicial Review in Market Manipulation Case*, FR No. 3128, pp. 33-36 and *Powhatan Energy Fund, in an Appeal from Heavy Civil Penalties, Putts FERC's View of Adjudication Process on Trial*, FR No. 3082, pp. 9-13.

the default path option where the subject of an investigation is entitled to a full adversarial hearing before an ALJ, the alternative path option does not provide full discovery rights in support of its defense, the judge said.

She cited other court rulings that found the fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner, and found that many of the other cases involving FERC assessment of penalties under the alternative path presented basic fairness concerns absent the applicability of Federal Rules of Civil Procedure.

"FERC's contention that the knowing waiver of a full adversarial hearing in order to obtain a more favorable standard of review in district court does not overcome the serious procedural deficiencies their proffered interpretation engenders," the judge said.

"The court declines to determine at this time whether Respondents are entitled to a trial by jury," Lauck said.

Now that the adjudication of the case is clear before the district court, "I predict 2018 will be a good year for Alan Chen and Powhatan," Gates said in his statement.

When Commissioner Neil Chatterjee was chairman at FERC, he mentioned how the courts have rejected FERC's interpretation of *de novo* review five times, and how he wanted to re-examine the issues so that the Commission's stance is legally defensible. Attorneys following FERC investigations and penalty cases have argued that the Commission should alter its stance that is costing the government and industry plenty of money in litigation expenses.

FERC Chairman Kevin McIntyre has not addressed the issue in depth, and Gates said he does not have any insight on what the change in leadership at FERC will mean for Powhatan and others in a similar position. In an email to *The Foster Report*, he joked that after more than seven years of not being successful in predicting how FERC would respond in enforcement proceedings, "I've given up trying to speculate."

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