

CLIENT ALERT

Powhatan Update: Disgorgement but No Penalty in Chen Defendants Settlement, Leaving Powhatan as Sole Remaining Defendant

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AUTHORS

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On October 29, 2021, the Federal Energy Regulatory Commission (“FERC” or the “Commission”) issued an Order Approving Stipulation and Consent Agreement (the “Consent Agreement”) between the Office of Enforcement (“OE”) and Dr. Houlian Chen, HEEP Fund, Inc. (“HEEP Fund”), and CU Fund, Inc. (“CU Fund” and, together with Dr. Chen and HEEP Fund, the “Chen Defendants”).¹ The Consent Agreement resolved, as it pertains to the Chen Defendants: (i) the Commission’s claims against them for violations of section 222 of the Federal Power Act (“FPA”) and 18 C.F.R. § 1c.2; and (ii) the Commission’s lawsuit captioned *FERC v. Powhatan Energy Fund LLC, et al.*, No 3:15-cv-00452 (MHL) (the “Federal Court Lawsuit”).² The Chen Defendants neither admitted nor denied the violations and agreed to pay \$600,000 in disgorgement to PJM Interconnection, L.L.C. (“PJM”). Dr. Chen also agreed to a two-year trader ban from FERC-jurisdictional markets and to participate in the Federal Court Lawsuit as a witness against Powhatan Energy Fund, LLC (“Powhatan”). The \$600,000 payment is less than five percent of the more than \$13 million in penalties and disgorgement assessed and sought by FERC from the Chen Defendants in the Federal Court Lawsuit.³

¹ 177 FERC ¶ 61,076 at P 1 (2021).

² Consent Agreement at P 1.

³ 151 FERC ¶ 61,179 at P 2 (2015) (hereinafter “Penalty Assessment”).

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Background

PJM operates both a day-ahead market and a real-time market in which generation is scheduled and dispatched to correct for variations between the day-ahead schedule and actual demand for electricity. Up To Congestion (“UTC”) transactions are financial transactions that permit market participants to arbitrage the difference between the day-ahead and real-time congestion prices at different locations in PJM’s territory. Under PJM’s rules at the time when the alleged violations occurred, PJM required market participants to reserve transmission service relating to their UTC trades, resulting in those participants becoming eligible to receive financial compensation in the form of transmission credits, Marginal Loss Surplus Allocation (“MLSA”) payments.⁴

On December 17, 2014, the Commission issued an Order to Show Cause and Notice of Proposed Penalty (the “OSC”) that required the Powhatan and Chen Defendants to show cause why they should not be found to have violated section 222 of the FPA and section 1c.2 of the Commission’s regulations, by engaging in fraudulent UTC transactions in PJM’s energy markets and why penalties should not be assessed.⁵ OE alleged that from June 1, 2010 to August 3, 2010, Powhatan and the Chen Defendants designed and implemented a market manipulation scheme involving UTC trading where they “ma[de] equal and opposite trades between the same two points (*i.e.*, a trade from A to B paired with a trade from B to A).”⁶ OE alleged that “these ‘round trip’ trades would cancel out [their] price risk and allow [them] to increase profits by ramping up [their] trading volume enormously.”⁷

The defendants have long maintained that no violations occurred and that merely taking advantage of a market inefficiency, such as using UTC transactions to collect MLSA payments, did not rise to the level of fraud and constitute a violation.⁸ Powhatan has maintained that the UTC transactions that it and Dr. Chen entered into were lawful based on existing PJM market rules.⁹ The defendants have contended that they simply exposed a loophole in then-existing energy market rules.¹⁰

⁴ Penalty Assessment at P 2.

⁵ 149 FERC ¶ 61,261 at P 1 (2014).

⁶ OSC, Appendix A (hereinafter “Staff Report”), at p. 2.

⁷ Staff Report at p. 2.

⁸ See, e.g., *Houlian Chen, et al.*, FERC Docket No. IN15-3-000, Response in Opposition to Order to Show Cause and Notice of Proposed Penalty at pp. 3-4 (Feb. 2, 2015) (“Response in Opposition”).

⁹ Response in Opposition at pp. 3-4.

¹⁰ *Id.* at pp. 7-8.

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On May 29, 2015, the Commission issued its Penalty Assessment, rejecting the defendants' arguments. The Commission ordered the following penalties and disgorgement:

Defendant	Civil Penalty	Disgorgement
Powhatan	\$16,800,000	\$3,465,108
CU Fund	\$10,080,000	\$1,080,576
HEEP Fund	\$1,920,000	\$173,100
Dr. Chen	\$1,000,000	N/A

As relevant here, the Commission held Powhatan jointly and severally liable for the penalties that it imposed against HEEP Fund and CU Fund.¹¹ On July 31, 2015, the Commission filed the Federal Court Lawsuit seeking an order affirming its Penalty Assessment, including the same penalty and disgorgement amounts on the same terms as in the Penalty Assessment.

Discussion

Although the Chen Defendants neither admitted nor denied the alleged violations, they stipulated to facts that appear calculated by FERC to support its case against Powhatan. For example, the Chen Defendants stipulated that Dr. Chen had two profit opportunities in mind for the UTC trading strategy at issue in the Federal Court Lawsuit, but he only ever communicated the opportunity to profit from targeting MLSA to Powhatan. They further stipulated that, to the best of Dr. Chen's knowledge and belief, he never communicated to Powhatan any other profit opportunity, aside from targeting MLSA, before or during the alleged period of manipulation.

It is difficult to determine from publicly available information what led to settlement of the Commission's claims against the Chen Defendants for only a fraction of the more than \$13 million in penalties and disgorgement ordered by FERC in the Penalty Assessment. The timing of the settlement is interesting because it occurred just a few weeks after the court-approved withdrawal of Steven Tabackman from the Federal Court Lawsuit. Mr. Tabackman had recently made headlines for apparently violating FERC's separation of functions regulations by improperly communicating with an

¹¹ Penalty Assessment at P 165.

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enforcement staff colleague via their personal email accounts.¹² A natural impression is that perhaps his withdrawal and the settlement are related, especially in light of FERC's acceptance of such a significant reduction in sanctions. However, the public record does not appear to corroborate such a connection other than the coincidental timing. Moreover, the fact that Powhatan was not part of a comprehensive settlement also tends to suggest that Mr. Tabackman may not have been a primary factor in the settlement.

The more straightforward explanation is in the Consent Agreement itself, which states that the Chen Defendants had claimed an inability to pay the assessed penalties and that they presented OE with sufficient evidence for OE to substantiate their inability to pay.¹³ Accordingly, inability to pay appears to be the most likely explanation for the Consent Agreement. In addition, Dr. Chen has agreed to testify should his testimony be required. Given the Chen Defendants' stipulations, FERC may have determined that it has a stronger case against Powhatan where Dr. Chen is prepared to testify that the only profit opportunity for the UTC trading strategy that he communicated to Powhatan was targeting the MLSA payments. In white collar and civil enforcement actions involving multiple defendants, it is not uncommon to see the government resolve matters against some parties, obtain agreements to testify from them, and to focus its efforts against the remaining defendant.

Conclusion

For now, the Commission's case against Powhatan marches on. Whether the Commission will continue to try to hold Powhatan jointly and severally liable for the HEEP Fund and CU Fund civil penalty amounts appears to be an open question, as is how Powhatan would defend against this argument. Perhaps we will see litigation over whether FERC can seek to recover penalties from Powhatan on grounds of joint and several liability where a party sharing joint and several liability has settled by paying no penalty. Alternatively, these and other issues may prove to be moot if Powhatan faces an inability to pay similar to the Chen Defendants—a possibility for which there is already some evidence in the public record. On July 26, 2021, Powhatan's counsel at the time filed a motion for leave to withdraw, citing concerns over their client's ability to pay future legal fees and related expenses.¹⁴ Another settlement conference currently is scheduled in the Federal Court Lawsuit for November 17, 2021, so stay tuned.

¹² *GreenHat Energy, LLC*, FERC Docket No. IN18-9-000, Expedited Motion to End Enforcement Action Against the Estate of Andrew Kittel, to Ban Steven Tabackman and Thomas Olson from Future Involvement, and For an Investigation by Other Offices Within the Commission at p. 2 (Oct. 5, 2021).

¹³ Consent Agreement at P 10.

¹⁴ See *FERC v. Powhatan Energy Fund, LLC, et al.*, No. 3:15-cv-00452, Memorandum In Support of Motion of Counsel for Leave to Withdraw at 3 (E.D. Va. July 26, 2021), ECF No. 208.

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