FERC Alleges PJM Manipulation by Powhatan

Article By:

Robert E. Pease

On August 5, 2014, the **Federal Energy Regulatory Commission's** (FERC) Secretary, at the direction of the Division of Enforcement, issued a **Notice of Alleged Violations** against **Powhatan Energy Fund, LLC,** a hedge fund owned by brothers Kevin and Richard Gates. In the Notice, FERC Enforcement alleged that Powhatan's trader, Dr. Houlian Chen, engaged in Up to Congestion trades in the PJM market that allegedly were the equivalent of wash trades in violation of FERC's anti-manipulation rule. FERC's Notices generally reveal little about the matter under investigation. However, in this case we know a great deal about Enforcement's case because Powhatan itself publically disclosed much of the investigative record.
See http://ferclitigation.com/legal-back-and-forth/. It has been Powhatan's contention that their actions have been transparent and fully consistent with the PJM tariff and FERC's rules. Nevertheless, in staff's preliminary findings, dated August 9, 2013, Enforcement alleged that Chen made the wash trades in order to capture millions of dollars from the Margin Loss Surplus Allocation (MLSA). FERC alleged that Powhatan entered the riskless trades in order to boost the volume of its trading thus increasing the MLSA payments.

FERC staff typically issues a Notice of Alleged Violations upon receiving settlement authority from the Commission. Powhatan though has vowed to fight Enforcement. In response to staff's preliminary findings, Powhatan's entire reply consisted of the following statement: "Your preliminary findings make no sense. Should you choose to proceed with a public notice against Powhatan…please be advised that they will respond publicly and forcefully." Now that the public notice has been issued, we expect a robust response from Powhatan.

If FERC continues to pursue this matter, the next step would be an order to show cause. Because this is an alleged violation under the Federal Power Act as opposed to the Natural Gas Act, Powhatan could elect to force FERC to assess a civil penalty and bring a de novo action in federal district court to enforce the penalty as opposed to before a FERC administrative law judge. If this matter does indeed end up in court, this will be the fourth challenge to FERC's enforcement authority in the past few months. Barclays is in federal district court challenging a $435 million civil penalty in California; Richard Silkman is contesting a $1.25 million civil penalty in federal court in Maine; and BP is challenging a $28 million civil penalty before a FERC administrative law judge. We expect that these challenges will clarify, at least in part, the reach of FERC's anti-manipulation rule.

National Law Review, Volumess IV, Number 218