CLIENT ALERT

FERC Imposes Substantial Penalties and Disgorgement in GreenHat Case Over Forceful Dissent of Commissioner Danly

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On November 5, 2021, over the dissent of Commissioner James P. Danly, the Federal Energy Regulatory Commission ("FERC" or the "Commission") determined that from September 2014 to June 2018 (the "Relevant Period"), GreenHat Energy, LLC ("GreenHat") and the other respondents engaged in a scheme to amass Financial Transmission Rights ("FTR") positions in the PJM Interconnection, L.L.C. ("PJM") market that had little or no associated collateral requirements, sell the few profitable FTRs they acquired, extract the revenues from the company for personal benefit, and abandon the company to go bankrupt, leaving PJM market participants to foot the bill.[1] Besides being one of the largest civil penalty assessments ever imposed by the Commission, the Order and Commissioner Danly's dissent raise several interesting legal issues, which we discuss below. They include the reliance on inferences from circumstantial evidence to establish scienter, the Commission's role in the Order to Show Cause ("OSC") process, the statute of limitations, and disgorgement.[2]

[1] *GreenHat Energy, LLC, et al.*, 177 FERC 61,073 PP 1, 30 (2021) (hereinafter "Penalty Assessment").

[2] We summarized the Commission's Order to Show Cause and Notice of Proposed Penalty ("OSC") against the Respondents in a May 28, 2021 Client Alert, *available here*.

The Commission found that GreenHat, John Bartholomew, Kevin Ziegenhorn, and Luan Troxel, in her capacity as Executor of the Estate of Andrew Kittell (the "Kittell Estate") (collectively, the "Respondents")[3] violated anti-manipulation provisions of the Federal Power Act ("FPA") and the Commission's regulations (the "Anti-Manipulation Rule") by engaging in a manipulative scheme in the FTR market operated by PJM. It also found that the Respondents committed related violations of the PJM Open Access Transmission Tariff ("Tariff") and PJM's Amended and Restated Operating Agreement ("Operating Agreement"). The Commission ordered the following penalties and disgorgement based upon the Respondents' violations:

Party	Civil Penalty	Disgorgement
GreenHat	$179,600,573	$13,072,428 jointly and severally
Bartholomew	$25,000,000	
Ziegenhorn	$25,000,000	
Kittell Estate	$0	

Commissioner Danly dissented based upon his determination that staff of the Office of Enforcement ("OE") failed to establish the alleged violations by a preponderance of the evidence.

Procedural History[4]

The GreenHat investigation began on June 25, 2018, when OE received a tip through the Enforcement Hotline from Kevin Kelley, CEO of an FTR trading firm called Roscommon Analytics. Kelley explained that he had met with Kittell in the fall of 2016 to discuss GreenHat's business and possible transactions with Roscommon. Kelley believed GreenHat's business to be "a classic case of market manipulation, taking advantage of market rules to defraud other participants."[5] OE opened an investigation and began issuing data requests. GreenHat produced documents initially, but appears to have stopped cooperating around the time when the Commission ordered a non-public formal investigation on December

[3] The Commission did not find that the Kittell Estate itself participated in the alleged unlawful scheme, only that the Kittell Estate represented Mr. Kittell after his passing. Mr. Kittell passed away on January 6, 2021. On May 4, 2021, the San Diego Probate Court named Troxel, Kittell's spouse, executor of Mr. Kittell's estate.

[4] We do not seek to reiterate the entire procedural history, which the Commission has done at paragraphs 12-24 of its Penalty Assessment.

[5] Penalty Assessment at P 12.

3, 2019, and referred the case to the Department of Justice. GreenHat stopped responding to data requests and, when Respondents sat for depositions, they invoked their Fifth Amendment right against self-incrimination.[6]

PJM FTR Market and Credit Requirements

PJM is the Regional Transmission Organization (or "RTO") that operates the wholesale electricity market and coordinates the transmission of electricity in the District of Columbia and 13 states. It is the largest RTO in the U.S. and serves around 65 million people. PJM's operating procedures, market rules, and transmission planning and expansion protocols are contained in its Tariff. In addition to running day-ahead and real-time energy auctions, PJM conducts periodic auctions for FTRs, which are purely financial instruments with returns that depend on day-ahead congestion prices across a future period.

Utilities may use FTRs to hedge against congestion charges they could incur from electric grid congestion in the PJM footprint; however, PJM also permits financial firms such as GreenHat to trade FTRs for speculative purposes.[7] An FTR has a positive or negative value for a given hour "based on the difference (or 'spread') between the congestion prices at two nodes specific to the FTR - the node where energy enters the system (the 'source') and the node where the energy leaves the system (the 'sink') during that hour."[8] The FTR has a positive value for the hour when the congestion price at the sink is higher than the source and has a negative value when the converse occurs.

During the Relevant Period, FTRs could be purchased in auctions for periods of a month, a quarter, a year, or three years. Importantly, the acquirer of an FTR in an auction did not pay the purchase price until the later settlement date for that particular FTR. Depending upon the term of the FTR, the settlement date was as much as three years later.[9] Significantly, until that date, the only cash the purchaser had to put up was collateral calculated pursuant to PJM's formula. However, market participants could buy and sell FTRs bilaterally outside of the PJM-administered FTR market, which was a way for an FTR holder to generate cash prior to settlement. Under PJM's Tariff, losses on defaulted FTRs were "socialized" among all other PJM members, even though the other members may never have owned any FTRs.

PJM's formula for calculating collateral requirements for FTR positions during the Relevant Period has been criticized as inadequate.[10] PJM took certain inputs and, based upon weighted historical prices, calculated the difference between the

6 *Id.* at P 14. The precise date of the referral to the Department of Justice does not appear to be public, but Respondents argued that the Commission had "'effectively silenc[ed]'" them by referring the matter to the Department of Justice "'early.'" *Id.* at P 136 n330.

7 *Id.* at P 4.

8 *Id.* at P 5.

9 *Id.* at PP 5-6.

10 For example, a 2019 report to the PJM Board analyzed failings by PJM that contributed to GreenHat's ability to amass such a large FTR position without adequate collateral. *See* Anderson & Wolkoff, *Report of the Independent Consultants on the GreenHat Default* (Mar. 26, 2019) (hereinafter the "Independent Report"), *available here*.

historical value and the market participant's bid price for the FTR.[11] If the calculated historical value of a particular FTR was higher than the user's bid price, the user did not need to post collateral to hold the FTR, beyond the minimum $500,000 amount required to participate in the FTR market. In some cases, a market participant could buy additional FTRs while reducing its overall credit requirement because PJM would return "excess" collateral to the market participant.[12]

The Commission's Penalty Assessment

The Commission determined that the Respondents violated the Anti-Manipulation Rule in "four related but distinct ways."[13] The Anti-Manipulation Rule prohibits: (1) using a fraudulent device, scheme, or artifice, or making a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule, or regulation, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity (*i.e.*, "deceptive or manipulative conduct"); (2) with the requisite scienter; (3) in connection with the purchase, sale or transmission of electric energy subject to the jurisdiction of the Commission.[14] The Commission has explained that the Anti-Manipulation Rule prohibits fraud, which includes, but is not limited to, "any action, transaction, or conspiracy for the purpose of impairing, obstructing, or defeating a well-functioning market."[15]

In *GreenHat*, the Commission found that OE proved the alleged Anti-Manipulation Rule violation by a preponderance of the evidence in "four related but distinct ways," determining that Respondents:

1. engaged in a manipulative scheme in PJM's FTR market consisting of acquiring an FTR portfolio made up of primarily long-term FTRs with virtually no supporting, upfront capital, planning not to pay for losses at settlement, and obtaining cash for the individual Respondents by selling profitable FTRs to third parties at a discount;

2. purchased FTRs based not on market considerations but to amass as many FTRs as possible with minimal collateral, thereby engaging in a course of conduct for the purpose of impairing, obstructing, or defeating a well-functioning market;

[11] Penalty Assessment at P 10.

[12] *Id.* at P 11.

[13] *Id.* at P 30.

[14] 18 C.F.R. § 1c.2; *Prohibition of Energy Market Manipulation*, Order No. 670, 114 FERC ¶ 61,047, at P 38, *reh'g denied*, 114 FERC ¶ 61,300 (2006).

[15] Order No. 670, 114 FERC ¶ 61,047 at P 50.

3. made false statements to PJM regarding money purportedly owed by Shell with the intent to convince PJM not to proceed with a planned margin call; and

4. submitted inflated bids into the PJM long-term FTR auction with the intent to artificially raise the clearing price of FTRs that Shell had purchased from GreenHat and offered for sale in the auction.[16]

In addition, the Commission found that GreenHat violated both the PJM Tariff when it made false certifications to PJM about its compliance with risk management protocols and the PJM Operating Agreement requiring market participants to pay unpaid bills.[17]

In the sections below, we discuss several issues raised by Commissioner Danly's dissent and other insights regarding the GreenHat order.

Burden of Proof and Reliance on Inference

The facts in GreenHat are somewhat unusual for Commission enforcement actions because the Respondents did not cooperate. After producing some documents early in the investigation, the Respondents refused to answer substantive questions in depositions or narrative responses. The lack of cooperation appears to have been a consequence of an early referral by the Commission of the matter to the Department of Justice. Regardless of the reason, the lack of cooperation forced OE to prove its case without access to the type of information it normally relies upon to meet its burden to establish allegations by a preponderance of the evidence.

The Commission found that OE had met its burden, but Commissioner Danly disagreed. Commissioner Danly issued a strongly worded dissent that criticized the Commission for unduly relying on inference to establish intent, without any of the evidence or corroboration needed for OE to meet its burden. Commissioner Danly explained that "the quantity and quality of evidence supporting Enforcement's allegations is remarkably sparse, especially given the length and extent of Enforcement's investigation and how high-profile a case this is. Instead, Enforcement's analysis is premised primarily on conclusory and unsubstantiated inferences from inferences."[18] In Commissioner Danly's view, "[t]he bottom line is this: if Enforcement provides no direct evidence in support of its theory based upon documents and inferences drawn from third-party statements, each of which 1) do not purport to describe GreenHat's state of mind and 2) are amenable to another

[16] Penalty Assessment at P 30. Although it listed several violations, the Commission explained that "we are assessing penalties and ordering disgorgement just once for all of Respondents' violations – this finding of a second, alternative violation does not increase the assessed penalty or required disgorgement." *Id.* at P 160.

[17] *Id.* at P 30.

[18] Penalty Assessment, Dissent (hereinafter "Dissent") at P 11.

equally plausible interpretation, Enforcement's evidentiary showing is insufficient."[19] In contrast, the Commission found that OE's and the Respondents' explanations were not equally plausible.

Commissioner Danly considered the Commission's inferences to be one-sided. He would have drawn inferences against OE that the Commission did not. For example, he was troubled by questions that OE left unanswered in a Commission process in which OE, and OE alone, has the ability to introduce evidence not in a Respondent's possession. As he explained, "when considering inferences, we also should consider the inference to be drawn from the failure of Enforcement to attempt to obtain or place into the record any direct evidence of the third-party witnesses' views of the evidence it cites. This is especially troubling because we know that Enforcement interviewed those witnesses but then placed no notes of the interviews in the record and declined to conduct on-the-record depositions."[20] He argued that when the documents purporting to evidence intent "are viewed objectively and not with a lens that sees everything as incriminating, they do not—by their own terms—purport to say anything about what GreenHat believed or what it intended."[21]

"A Lens that Sees Everything as Incriminating" - Prosecution or Adjudication?

Commissioner Danly's dissent suggests that there may be an underlying tension at the Commission over the Commission's proper role in assessing civil penalties where respondents elect *de novo* review in federal court. First, Commissioner Danly appeared to consider the Commission to be acting in more of a prosecutorial rather than adjudicatory role, which is a characterization that, as we explain below, can have significant implications. Second, he appeared to prefer a wider-ranging and more fairly balanced proceeding. We discuss each of these aspects of his dissent.

Commissioner Danly seemed to suggest that the Commission's inferences were one-sided because they were viewed through "a lens that sees everything as incriminating."[22] Elsewhere, Commissioner Danly described the Tariff and Operating Agreement violations "as simply stacking the litany of charges against GreenHat to see what ultimately sticks."[23] These are not characterizations of a Commission that is acting as a neutral adjudicator; rather, they would more aptly characterize a Commission acting in a prosecutorial role.

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19 Dissent at P 23.

20 *Id.* at 24. We expect that the Respondents will aggressively pursue these documents in discovery. The Commission will seek to protect the documents from disclosure based upon the work-product doctrine and any applicable privilege, but Commissioner Danly's dissent may give Respondents a basis upon which to seek *in camera* review. A judicial determination that the documents contain undisclosed *Brady* material (*i.e.*, exculpatory evidence) could materially impact the litigation.

21 *Id.* at P 20.

22 *Id.*

23 *Id.* at P 39.

It also appears that Commissioner Danly would have preferred a wider-ranging investigation and OSC process with more rigorous evidentiary standards—perhaps something more like an adjudication in federal court. For example, as indicated above, he was troubled by "the fact that Enforcement took no depositions of any of the key third-party actors mentioned in its report."[24] In addition, he criticized the Commission's reliance on hearsay evidence to "prove the matter asserted," drawing upon a concept from the Federal Rules of Evidence that govern evidentiary matters in federal court.[25] A federal litigation would feature third party depositions, because the defendants could demand them, and more rigorous evidentiary standards.

By contrast, Commissioner Danly observed that "Enforcement alone" had the ability to put third-party documents "in the record" before the Commission.[26] As a consequence, he criticized OE for not introducing its investigatory notes of third-party interviews and would have drawn adverse inferences against OE for failing to do so.[27] For its part, the Commission dealt with his concern in a footnote, taking the position that OE can conduct its investigation as it sees fit and may have good reasons not to produce its interview notes, such as attorney work product concerns.[28]

The fundamental question of the Commission's proper role in assessing civil penalties where a respondent elects *de novo* review—prosecutor or adjudicator—appears to underlie these disputes between the majority and dissent.[29] Respondents have argued that the Commission acts in a prosecutorial role during the OSC process whereas the Commission has maintained that it conducts a fair and impartial adjudication of OE's allegations. Who is correct carries potentially dispositive consequences for statute of limitations purposes.

The applicable statute of limitations, 28 U.S.C. § 2462, requires the Commission to initiate a "proceeding"—*i.e.*, an adjudication—within five years of the alleged violation. The Commission relies on the OSC process initiating a "proceeding" to meet the statute of limitations requirement. But if the OSC process is a prosecutorial determination rather

[24] *Id.* at P 12.

[25] *Id.* at P 30, n.50.

[26] *Id.* at P 13.

[27] *Id.* at PP 13; 24.

[28] Penalty Assessment at P 136 n.330.

[29] We have discussed the *de novo* review issue in detail in several Client Alerts and do not seek to retread that ground here. *See, e.g.*, Pantano *et al.*, *Federal Court Allows FERC's Case in Silkman to Proceed—Is a Circuit Split Brewing?*, (Jan. 16, 2019), *available here;* Pantano *et al., FERC Loses Yet Another Ruling on the Scope of De Novo Review in Federal Court*, (Jan. 3, 2018), *available here*; Pantano *et al., Another Federal Court Rejects FERC's Narrow View of the Scope of De Novo Review Under the Federal Power Act*, (Jan. 31, 2017), *available here*. In summary, litigants of Commission enforcement matters have long disputed the Commission's role—both its actual role and what its role should be under the FPA—in assessing civil penalties where the respondents elect *de novo* review in federal court. The Commission has taken the position that it conducts a full adjudication in its Order to Show Cause process, even where *de novo* review is elected and there will be a new and complete trial afterward. Defendants, on the other hand, and one United States District Court judge, have argued that the Commission's OSC process is one-sided and it really just a "decision to prosecute," rather than an adjudication.

than a section 2462 proceeding, then the Commission would need to file its complaint in federal court, thereby initiating a section 2462 proceeding, within five years of the alleged violation to fall within the limitations period.[30] At least in GreenHat, Commissioner Danly appears to believe that the Commission acted in a prosecutorial rather than an adjudicator capacity. Accordingly, Respondents may use Commissioner Danly's dissent in a motion to dismiss on statute of limitations grounds.

Statute of Limitations

There is likely to be litigation over the application of the statute of limitations. Respondents argued that at least a portion of the conduct fell outside the statute of limitations, even after accounting for the various tolling agreements signed by the parties. However, the Respondents' Answer appears to have sought merely to preserve the argument and does not go into specifics. The Commission considered the issue and concluded that the statute of limitations "has no impact on the Commission's findings."[31] The Commission reasoned with respect to the first two Anti-Manipulation Rule violations that "GreenHat sold or defaulted on all of the relevant FTRs during the statute of limitations; therefore, our inclusion of all of those FTRs in the penalty assessment is not constrained by the statute of limitations."[32] Even if the Commission were wrong about that, it concluded, "[I]nclusion of such conduct in the violation would still be proper pursuant to the 'continuing violation' doctrine."[33] The Commission further concluded that with respect to the third and fourth Anti-Manipulation Rule violations, as well as the Tariff and Operating Agreement violations, the conduct occurred entirely within the manipulation period.

Disgorgement

The majority and dissent also disagreed over the imposition of disgorgement on the Kittell Estate. The Commission determined that imposing disgorgement on the Respondents, including the Kittell Estate, jointly and severally was appropriate. It reasoned that in recent cases it had imposed liability for disgorgement in this manner where "'multiple respondents collaborate or have a close relationship in executing the fraud.'"[34] The Commission rejected the Respondents' argument that "the possibility of one defendant having to disgorge more money than he received as a result of his unlawful conduct automatically transforms disgorgement into a penalty."[35]

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30 *Fed Energy Regul. Comm'n v. Barclays Bank PLC*, No. 2:13-CV-02093-TLN-DB, 2017 WL 4340258, at *12-14 (E.D. Cal. Sept. 29, 2017).

31 Penalty Assessment at P 243.

32 *Id.*

33 *Id.*

34 *Id.* at P 307.

35 *Id.*

Commissioner Danly acknowledged the Commission's broad authority to order disgorgement, but took issue with the imposition of disgorgement against the estate. He noted that the Commission did not propose to seek any penalties from the Kittell Estate, which he saw as "an implicit concession that it has no authority to do so."[36] Commissioner Danly saw the imposition of joint and several disgorgement liability on the Kittell Estate as "nothing more than a back-door maneuver to penalize the Kittell Estate by making it liable for disgorgement of profits that went to the other respondents."[37] In his view, it would be "fundamentally unfair and improperly punitive to require an estate to disgorge funds that ended up in the hands of the other respondents."[38] The Commission, in contrast, did not distinguish between Kittell and his estate in this regard, stating that it saw "no reason why those harmed by Respondents' fraud should receive less than the full amount of GreenHat's unjust profits, simply because GreenHat and its owners distributed those unjust profits among themselves."[39]

Conclusion

The 138-page Penalty Assessment and 18-page Dissent are full of compelling issues for FERC observers. As the case proceeds to federal court, it will be interesting to see how things develop. However, it is not clear whether Respondents will have sufficient resources to continue to litigate.

If they do, we anticipate that they will leverage Commissioner Danly's dissent as much as possible. They may move to dismiss on statute of limitations and other grounds. They likely will emphasize the lack of process before FERC and seek a full trial, with expansive discovery, after the motion to dismiss phase. They will seek to depose the third-party witnesses whom OE did not, and they may attempt to seek production of OE's notes and other materials as potentially exculpatory and to try to ascertain why OE did not place that information in the record. The Commission will no doubt assert privilege or work product doctrine and argue that even in criminal cases there is no duty to disclose interview notes unless the notes contain *Brady* or Jencks material,[40] but the Respondents are likely to seek discovery. That Commissioner Danly was willing to draw adverse inferences against OE because it did not put this evidence in the record suggests his concerns over the lack of transparency. If the defendants discover any exculpatory evidence that should have been disclosed by OE, it could be a significant development.

[36] Dissent at P 43.

[37] *Id.*

[38] *Id.*

[39] Penalty Assessment at P 308.

[40] The Jencks Act requires the government in criminal cases to produce verbatim statements of its witnesses after the witness has testified at trial. 18 U.S.C. § 3500.

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