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**U.S. Supreme Court's Jarkesy Decision Imperils FERC's Use of In-House Hearings to
Impose Civil Penalties¹**

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U.S. Supreme Court's Jarkesy Decision Imperils FERC's Use of In-House Hearings to Impose Civil Penalties²

On June 27, 2024, in *SEC v. Jarkesy*, the Supreme Court held that under the Seventh Amendment, the Securities and Exchange Commission (SEC) must bring civil-penalty actions for securities fraud in federal court, where the defendant is entitled to a jury, and cannot do so in an in-house administrative hearing.

The Supreme Court's decision is likely to have significant implications for the Federal Energy Regulatory Commission's (FERC) use of administrative hearings to adjudicate market manipulation and other fraud-like claims, as FERC's in-house enforcement procedures are derived from the securities laws. That said, the Court declined to resolve other constitutional claims that could affect FERC's use of in-house administrative law judges (ALJs) to adjudicate other matters, leaving lower courts to continue to grapple with those issues in the first instance.

The Supreme Court's Decision

The 6–3 majority opinion, written by the Chief Justice, holds that the Seventh Amendment entitles defendants to a jury trial when the SEC seeks civil penalties for securities fraud. As a result, the agency may no longer pursue such claims through in-house enforcement proceedings.³

Under the securities laws, the SEC has the option to pursue a civil penalty action in one of two forums.⁴ One option is to sue in federal court, which provides the defendant with all the

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³ *SEC v. Jarkesy*, 603 U.S. ____ (2024), No. 22-859, slip op. at 2 (June 27, 2024).

⁴ *Id.* at 6–7.

procedural safeguards that come with civil litigation.⁵ Alternatively, the SEC may adjudicate the matter internally, using relaxed evidentiary and discovery rules, followed by deferential judicial review.⁶ The SEC chose the latter option for its civil penalty action against George Jarkesy, Jr. and Patriot28, LLC, ultimately imposing a \$300,000 civil penalty for alleged securities fraud.⁷ Jarkesy challenged the order, arguing that the SEC had violated his Seventh Amendment right to a jury trial when it adjudicated the matter in-house.⁸ The Fifth Circuit agreed and vacated the order.⁹ The Supreme Court affirmed.

The Court’s opinion proceeds in two parts. The Court first reasoned that the Seventh Amendment right to a jury trial is implicated when the SEC seeks civil penalties for securities fraud.¹⁰ The Court began by analyzing the text of the Seventh Amendment, which guarantees that the “right of trial by jury shall be preserved” in “[s]uits at common law.”¹¹ That language, it explained, extends to statutory claims that are “legal in nature.”¹² Looking at two factors, the Court concluded that a securities fraud action is just such a claim. First, it noted that the SEC’s desired remedy — civil penalties — is a punitive form of monetary relief that was traditionally awarded in courts of law, not courts of equity.¹³ Second, the Court observed that securities fraud

⁵ *Id.* at 3.

⁶ *Id.*

⁷ *Id.* at 1.

⁸ *Id.* at 5.

⁹ *Id.*

¹⁰ *Id.* at 6.

¹¹ *Id.* at 8.

¹² *Id.*

¹³ *Id.* at 9, 11.

resembles common law fraud.¹⁴ Taken together, these considerations showed that an action for securities fraud is “legal in nature,” presumptively entitling *Jarkesy* to a jury trial.

Next, the Court held that the “public rights” exception, which allows Congress to assign certain matters to an agency decisionmaker, did not apply.¹⁵ The majority concluded that this holding followed logically from the Court’s decision in *Granfinanciera, S.A. v. Nordberg*.¹⁶ The question under *Granfinanciera* is whether a given suit is substantively akin to a suit at common law.¹⁷ Here, the SEC sought punitive remedies, “target[ing] the same basic conduct as common law fraud, employ[ing] the same terms of art, and operat[ing] pursuant to similar legal principles.”¹⁸ That confirmed that this action involved private — not public — rights, so the public-rights exception did not apply.¹⁹

Justice Sonia Sotomayor dissented, joined by Justices Elena Kagan and Ketanji Brown Jackson. The dissent argued that the SEC’s in-house adjudications pass muster under *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*, which upheld the constitutionality of the Occupational Safety and Health Administration’s use of administrative hearings to impose civil penalties for workplace safety violations.²⁰ The majority distinguished *Atlas Roofing* on the ground that, unlike this case, the workplace-safety claims in *Atlas Roofing* were “unknown to the common law.”²¹

¹⁴ *Id.* at 11.

¹⁵ *Id.* at 6-7.

¹⁶ *Id.* at 19–20.

¹⁷ *Id.* at 19, 21.

¹⁸ *Id.* at 21.

¹⁹ *Id.* at 27.

²⁰ *Id.* at 23.

²¹ *Id.* at 24–25.

Implications for FERC Enforcement

The Supreme Court's holding in *Jarkesy* applies only to the securities laws, but its reasoning sweeps more broadly. The Court strongly suggests that any agency enforcement action for civil penalties that is based on common-law-type fraud claims must be brought in a federal court, where the defendant has a right to a jury, and cannot be adjudicated in an in-house administrative proceeding.

This very likely will implicate FERC enforcement actions for market manipulation, which are inherently based on fraud, under both the Natural Gas Act and the Federal Power Act.

Natural Gas Act

Under the Natural Gas Act, FERC enforcement proceedings can only be brought before an ALJ in the first instance.²² If FERC imposes a penalty, the defendant has the right to seek judicial review, and FERC's factual findings are entitled to deference on a substantial-evidence standard.²³ The Natural Gas Act's enforcement provisions are similar to the securities laws at issue in *Jarkesy*. Thus, several subjects of ongoing FERC enforcement actions under the Natural Gas Act filed amicus briefs in *Jarkesy* arguing that FERC's use of administrative hearings to impose civil penalties for market manipulation and other fraud-based claims violates the Seventh Amendment for the same reasons the Supreme Court held that the SEC's administrative enforcement process did so.²⁴ The U.S. Court of Appeals for the Fifth Circuit and a federal

²² 15 U.S.C. § 717n.

²³ *Id.* § 717r(b).

²⁴ See Brief of Energy Transfer LP as *Amicus Curiae* in Support of Respondents, *SEC v. Jarkesy*, No. 22-895 (Oct. 2023); Brief of TotalEnergies Gas & Power N. Am., Inc. as *Amicus Curiae* in Support of Respondents, *SEC v. Jarkesy*, No. 22-859 (Oct. 2023).

district court in Texas — which are currently presiding over challenges to FERC Natural Gas Act administrative enforcement actions — are likely to take up this issue in the near future.

Federal Power Act

The Federal Power Act presents a more complex question. Under both the Natural Gas Act and the securities laws at issue in *Jarkesy*, defendants have no choice as to where a civil penalty action is brought against them. As noted, the Natural Gas Act requires an administrative hearing in the first instance, and the securities laws gave the SEC the option on where to proceed.

By contrast, the Federal Power Act gives the defendant the option on whether a civil penalty action is brought in federal court or in an administrative hearing (which is followed by “de novo” judicial review in a federal court).²⁵ *Jarkesy* strongly indicates that such an administrative hearing at FERC would violate the Seventh Amendment if the defendant were required to undertake it before getting a day in court. But it is an open and interesting question whether the option the defendant possesses under the Federal Power Act affects the Seventh Amendment analysis.

Discovery in civil penalty actions

The *Jarkesy* ruling also has implications for discovery. While an agency may always investigate before filing a complaint — which may include issuing subpoenas or civil investigative demands to a regulated entity — *Jarkesy* states that it may not “compel [a regulated

²⁵ 16 U.S.C. § 823b(d).

party] to defend [itself] before [the] agency rather than before a jury in federal court.”²⁶ The likely upshot is that agencies subject to *Jarkesy*’s holding will have to conduct discovery, including depositions, in a manner consistent with the Federal Rules of Civil Procedure. In that case, the regulated party would also have the right to demand discovery.

Other constitutional issues

Finally, the Supreme Court’s *Jarkesy* decision does not address agencies’ use of administrative hearings to address matters that do not involve fraud or other claims with common-law analogs. Nor does it address agencies’ use of administrative hearings to impose remedies other than civil penalties. For instance, the decision does not prohibit FERC from using ALJs to make permitting decisions under the Natural Gas Act or the Federal Power Act.

Other constitutional challenges have been raised that could affect FERC’s use of ALJs for such other purposes, but the Supreme Court declined to address them.

For instance, the petitioner in *Jarkesy* argued that Congress violated Article II by improperly insulating the SEC’s ALJs from removal by the President. Substantially similar arguments have been made against FERC in ongoing litigation. At both the SEC and FERC, ALJs enjoy for-cause removal protections and are appointed by Commissioners who enjoy the same for-cause removal protections. In *Jarkesy*, the Fifth Circuit held that the SEC arrangement violated Article II; the Supreme Court left the question open for another day.

In addition, by not overruling its prior decision in *Atlas Roofing* — which upheld OSHA’s use of administrative hearings to impose civil penalties for workplace safety violations

²⁶ *Jarkesy*, 603 U.S. ___, slip op. at 1.

— the Court left open whether it is constitutionally appropriate for ALJs to adjudicate claims that do not have a clear analog at common law.

For example, FERC historically has brought enforcement actions to revoke or condition energy marketers’ or sellers’ market-based rate authorizations. FERC has also done the same to enforce natural gas blanket market certificates. Market-based rate authorizations and market certificates are creatures of statute. Thus, especially in cases in which civil penalties are not at stake, FERC may argue that such enforcement actions are not analogous to common law claims that are subject to the Seventh Amendment’s right but rather are “public rights” that may be adjudicated by an in-house ALJ.

For defendants, federal courts offer multiple advantages over an administrative hearing. Federal courts provide the right to a jury trial and the protections of the Federal Rules of Civil Procedure and Evidence, which include prohibitions on hearsay and the opportunity for discovery against the government. After *Jarkesy*, federal courts are likely to become the default forums for FERC and other agency enforcement actions seeking to impose civil penalties for fraud and other common law claims.

Whether federal courts continue to pare back federal agencies use of in-house hearings in other settings will be a question for future litigation.

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