

Client Alert: Under *Jarkesy*, FERC's Penalty Assessment Schemes Are Unconstitutional

Client Alerts

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In *SEC v. Jarkesy*, the Supreme Court considered whether the Seventh Amendment permits the SEC “to compel respondents to defend themselves before the agency rather than before a jury in federal court.”^[1] The Court held that the SEC cannot adjudicate civil penalties “through its own in-house proceedings” because that adjudication triggers the Seventh Amendment’s right to a jury trial in federal court.^[2]

As we explain below, this holding should equally apply to FERC’s statutory penalty assessment schemes under the Federal Power Act (“FPA”), the Natural Gas Act (“NGA”), and the Natural Gas Policy Act of 1978 (“NGPA”).

BACKGROUND

The idea of adding civil penalties to the arsenal of administrative agencies is an old one, predating the 1946 enactment of the Administrative Procedure Act (“APA”). But constitutional concerns about that approach are just as old. In 1941, the Attorney General’s Committee on Administrative Procedure recommended that Congress grant civil penalty authority to federal administrative agencies, but also stated that “in order to resolve any doubts about the constitutionality of the procedure, . . . the aggrieved person be permitted review de novo by a [f]ederal district court.”^[3]

Many statutory civil penalty schemes followed the de novo review structure. But there also were many variations. By 1979, Congress had created 348 different civil penalty schemes enforced by 27 different federal entities.^[4] On one end of the statutory spectrum, some civil penalty schemes call for the agency to assess penalties and then to litigate them in-house before an administrative law judge (“ALJ”), subject to judicial review by a federal court of appeals under the APA’s arbitrary-and-capricious standard of review. On the other end of the statutory spectrum, some civil penalty schemes provide for adjudication in federal district court, with the agency acting solely as a prosecutor, without any prior agency hearing or assessment process. Between these two extremes are various schemes where the agency plays an initial role—often by “assessing” a specific penalty amount, and often subject to de novo federal district court review. In several reports to the

Administrative Conference of the United States, academics have categorized these myriad statutory civil penalty schemes like zoologists.^[5]

Reflecting this broad spectrum of statutory civil penalty structures, FERC itself has statutory duties under three different civil penalty schemes. Each scheme uses the same agency structure: FERC shall give notice and then can assess a civil penalty. But they each take different paths regarding whether another adjudication on the merits occurs before a FERC ALJ or in federal district court.^[6]

The NGPA came first, in 1978. There, Congress used a classic “de novo review” structure. FERC first must give “notice of the proposed penalty” to the person who allegedly committed a violation.^[7] Next, absent settlement, FERC must issue an order “assessing” civil penalties.^[8] Then, FERC “shall” file a civil action in federal district court seeking “an order affirming the assessment of the civil penalty.”^[9] The court is authorized “to review de novo the law and the facts involved.”^[10]

The FPA followed in 1986, when Congress added a civil penalty structure that is unusual by any measure. That statutory scheme later was amended in 2005. Under the FPA, absent a settlement, the person facing proposed civil penalties gets to choose between adjudicating the merits before (1) a FERC ALJ or (2) a federal district court exercising de novo review.^[11]

Regardless of the chosen path, the FPA, like the NGPA, requires FERC to give notice to the target and to issue an order assessing civil penalties.^[12] In addition, the FPA requires FERC to give an “opportunity for public hearing” before it can issue an order assessing penalties.^[13] And the FPA requires FERC, when choosing what penalty amount to assess, to consider “the nature and seriousness of the violation,” along with any efforts “to remedy” it.^[14]

Finally, Congress amended the NGA in 2005 to add civil penalty authority for the first time.^[15] The NGA amendments essentially copy the FPA’s mandatory initial steps, calling for FERC to assess civil penalties after notice and opportunity for hearing, considering the nature and seriousness of the violation and efforts to remedy it.^[16] Unlike the FPA and NGPA, however, the NGA says nothing about what happens next. There is no election for the subject to make between trying the case before an ALJ or in federal district court. Aside from FERC’s penalty assessment process, there is nothing about how, when, and where civil penalties will be adjudicated. For over fifteen years, however, FERC has consistently held that, absent settlement, it must use in-house ALJs to adjudicate NGA civil penalties on the merits, subject to judicial review by a federal court of appeals applying a deferential standard of review.^[17]

ANALYSIS

It might seem counterintuitive for the FPA, NGA, and NGPA all to run afoul of the Seventh Amendment right to a jury trial under *Jarkesy*. The constitutional defect in the NGA is particularly

patent—there, Congress made no express provision for district court adjudication of civil penalties. In contrast, the other two statutes provide de novo review in federal district court, where a jury trial is available. Nevertheless, the three statutes all have the same fatal constitutional flaw. Each one mandates that FERC must give notice and then can assess a civil penalty. Congress therefore has required FERC to engage in its own adjudication. And that adjudication violates the Seventh Amendment.

This conclusion stands out in sharp relief when viewed against the backdrop of two recent court of appeals decisions addressing how the government-wide five-year statute of limitations on civil penalties applies to FERC’s FPA civil penalty scheme. These two cases, *Powhatan* and *Vitol*, explain that FERC’s in-house penalty assessment process is itself an adjudication—one that is a necessary statutory predicate to any cause of action in federal district court.^[18]

As the Fourth Circuit explained, “Congress *plainly conditioned FERC’s right to bring an action in federal district court* on the occurrence of a number of statutorily mandated events,” culminating in a Commission order assessing a penalty—and “[o]nly upon satisfaction of these requirements did Congress direct that FERC ‘shall institute an action’ in federal district court.”^[19] The Ninth Circuit agreed, holding that FERC’s cause of action in federal court “*does not exist until FERC has assessed a civil penalty.*”^[20] The district court “review[s]” FERC’s penalty assessment order.^[21]

As the Fourth Circuit also explained, FERC’s statutory civil penalty assessment process “contemplates extensive factfinding and the application of law to fact.”^[22] To elaborate:

- FERC must decide whether it thinks there were violations of law, requiring it to evaluate and find facts as well as interpret the law.
- FERC must decide whether to allege fraud or other elements of bad intent. Compared to allegations that rules somehow were inadvertently violated, claims of fraud can be game-changers.
- FERC must evaluate any arguments made by the defense. FERC’s regulations state that the subject can face summary disposition—a loss on the merits—if it fails to answer the show cause order with sufficient specificity.^[23] Not surprisingly, responses to show cause orders usually are lengthy and detailed. So are FERC’s penalty assessment orders.
- FERC must decide whether to assess civil penalties.
- FERC must decide whether to assess civil penalties only against the company or also against individuals.
- FERC must choose the dollar amount of civil penalties to assess. Under the FPA and NGA, that requires FERC to evaluate the nature and seriousness of the allegations, along with any efforts

to remedy them. In some cases, FERC has sought hundreds of millions of dollars.

- Finally, FERC must decide what amount of money to demand in settlement.

In practical terms, FERC's adjudication of these issues can cause serious harm to companies and individuals. When FERC assesses civil penalties, companies, and sometimes individuals, are publicly found to have violated the law, perhaps fraudulently. That can cause serious reputational injury. And although FERC itself cannot impose any obligation to pay the civil penalties it assesses, the monetary sanctions the government seeks nonetheless can have crushing effects. Companies may need to take steps regarding disclosure and accounting. Access to capital can be constrained. So can the ability to participate in FERC-jurisdictional markets. The availability of a later adjudication in court does nothing to remedy these injuries.

This statutory structure offends the Constitution. That the FPA allows, and the NGPA requires, eventual adjudication on the merits in federal district court makes no constitutional difference because the district court's involvement is predicated on a prior assessment of civil penalties by the agency. Under *Jarkesy*, "the judicial power of the United States cannot be shared with the other branches."^[24] But the FPA, NGA, and NGPA each share judicial power with FERC through the penalty assessment process. That violates the Seventh Amendment.

There are two possible exceptions to this outcome. First, a party facing civil penalties might waive the right to a jury trial. Second, the substance of the civil penalty dispute might be equitable instead of legal. As *Jarkesy* emphasizes, under common law, equitable claims did not require a trial by jury, while legal claims did.^[25] But *Jarkesy* sweeps broadly on this last point, stating that the remedy sought by the SEC is "all but dispositive."^[26] "What determines whether a monetary remedy is legal is if it is designed to punish or deter the wrongdoer, or, on the other hand, solely to 'restore the status quo.'"^[27]

In sum, the civil penalties in this case are designed to punish and deter, not to compensate. They are therefore a type of remedy at common law that could only be enforced in courts of law. That conclusion effectively decides that this suit implicates the Seventh Amendment right, and that a defendant would be entitled to a jury on these claims.^[28]

The same is true for FERC's civil penalties under all three statutes, which are "designed to be punitive."^[29] As in *Jarkesy*, FERC's civil penalty authority under all three statutes is tied to "the perceived need to punish the defendant rather than to restore the victim," making them quintessentially legal in nature rather than equitable.^[30] As in *Jarkesy*, FERC's penalty authority is focused "on the culpability of the defendant and the need for deterrence, not the size of the harm that must be remedied."^[31] And as in *Jarkesy*, the sheer magnitude of civil penalties shows their punitive nature. In *Jarkesy*, the court found the SEC's maximum penalty amount of \$725,000 to be

“among the SECs most potent enforcement tools.”^[32] But FERC’s maximum penalty amount under its three statutes is over twice as high—currently \$1,544,000 per day per violation, meaning assessed penalties can total hundreds of millions, if not billions, of dollars.^[33] FERC’s civil penalties therefore are punitive sanctions by any measure. And that triggers the Seventh Amendment right to a jury trial under *Jarkesy*.^[34]

FERC’s penalty assessment process also triggers additional constitutional concerns. While the Supreme Court did not reach the Fifth Circuit’s other rulings, Justice Gorsuch adopted two of them in his concurrence.^[35] By those lights, the SEC process at issue not only violates Article III of the Constitution, by depriving defendants of an independent fact-finder, but also violates the Due Process Clause of the Fifth Amendment, by depriving defendants of the typical due process protections found in federal district court litigation. That is now the law in the Fifth Circuit, and litigants elsewhere probably will argue these points along with the jury trial issue.^[36]

Footnotes

[1] 144 S.Ct. 2117, 2126-27 (2024).

[2] *Id.* at 2125.

[3] Report of the Attorney General’s Committee on Administrative Procedure, Sen. Doc. No. 8, 77th Cong., 1st Sess. 147 (1941).

[4] Colin Diver, *The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies*, 1979 ACUS 23 (1979), 79 Columbia L. Rev. 1435, 1438 (1979); *see also* Harvey J. Goldschmid, *An Evaluation of the Present and Potential Use of Civil Money Penalties as a Sanction by Federal Administrative Agencies*, 2 Recommendations and Reports of the Administrative Conference of the United States 896 (1972); William Funk, *Close Enough for Government Work?—Using Informal Procedures for Imposing Administrative Penalties*, 1993 ACUS 43 (1993), 24 Seton Hall L. Rev. 1 (1993).

[5] *See, e.g., id.*

[6] We leave aside FERC’s civil penalty authority under the Interstate Commerce Act because the penalties are much smaller, *see Civil Monetary Penalty Inflation Adjustments*, 186 FERC ¶ 61,017 at P 8 (2024), and very rarely used.

[7] NGPA § 504(b)(6)(E), 15 U.S.C. § 3414(b)(6)(E).

[8] *Id.* FERC previously claimed authority under the NGPA to conduct an ALJ trial to decide whether to issue a penalty assessment order, even though the case would eventually end up being tried again in federal district court. But that case settled before a court could weigh in. *See Energy Transfer Partners, L.P. v. FERC*, 567 F.3d 134 (5th Cir. 2009).

[9] NGPA § 504(b)(6)(F), 15 U.S.C. § 3414(b)(6)(F).

[10] *Id.*

[11] FPA § 31(d), 16 U.S.C. § 823b(d); FPA § 316A(b), 16 U.S.C. § 825o-1(b). Before that “fielder’s choice” structure was added to the FPA, it was used in three earlier energy-related statutes enacted in the late 1970s. *Compare* FPA § 31(d), 16 U.S.C. § 823b(d), *with* 42 U.S.C. § 2282a(c) (Atomic Energy Act), 42 U.S.C. § 8433(d) (Powerplant and Industrial Fuel Use Act of 1978), *and* 42 U.S.C. § 6303(d) (National Energy Conservation Policy Act of 1978). The legislative history of this last statute is interesting. As the conference reports explain, the Senate Energy Committee, led by J. Bennett Johnston, argued in favor of adjudicating the merits of civil penalties in federal district court, while the House Energy and Commerce Committee, led by John Dingell, argued in favor of adjudicating the merits of civil penalties in-house before an agency ALJ. At that point, the Supreme Court had just ruled, in *Atlas Roofing Co., Inc. v. Occupational Safety and Health Review Comm’n*, 430 U.S. 442 (1977), that litigating the merits of civil penalties before an agency ALJ did not violate the Seventh Amendment. One of the members in the conference suggested giving the party facing civil penalties the right to elect between adjudicating the merits before either an agency ALJ or a federal district court. Tr. of Proceedings, Joint Conference on Energy, 95th Cong. (Oct. 24, 1977). The Senate Energy Committee staff drafted statutory text to that effect overnight, which the conference members deployed the next day in the National Energy Conservation Policy Act. Tr. of Proceedings, Joint Conference on Energy, 95th Cong. (Oct. 25, 1977). That same text ended up in all three 1970s-era statutes—and then, eight years later, in the FPA.

[12] FPA § 31(d)(1), 16 U.S.C. § 823b(d)(1); FPA § 316A(b), 16 U.S.C. § 825o-1(b).

[13] FPA § 31(c), 16 U.S.C. § 823b(c); FPA § 316A(b), 16 U.S.C. § 825o-1(b).

[14] *Id.* In addition, the FPA and the NGPA both require the government, after assessing penalties, to wait 60 days before filing a civil action in court. FPA § 31(d)(3)(B), 16 U.S.C. § 823b(d)(3)(B); NGPA § 504(b)(6)(F), 15 U.S.C. § 3134(b)(6)(F). The three preceding 1970s-era statutes each contain the same 60-day standstill period. *See* 42 U.S.C. § 2282a(c); 42 U.S.C. § 6303(d); 42 U.S.C. § 8433(d). That defined standstill period was included to allow for settlement talks. The expectation was that most civil penalty disputes would settle. An entity facing penalties for allegedly violating the terms of a hydroelectric license often rationally would prefer to pay money to resolve the matter rather than risk losing the license entirely. And settlement has proven the norm ever since, though it typically occurs before or after the statutory 60-day standstill period. To this day, the civil penalty settlement process gives considerable leverage to the government—what one early commenter called “a kind of administrative blackmail.” Dalmas H. Nelson, *Administrative Blackmail: The Remission of Penalties*, 4 West. Pol. Q. 610-620 (1951), *quoted in* Walter Gellhorn, *Administrative Prescription and Imposition of Penalties*, 1970 Washington University Law Quarterly 265, 280 (1970); *see generally* Phillip Hamburger, *Purchasing Submission: Conditions, Power, and Freedom* (2021).

[15] NGA § 22(a)-(b), 15 U.S.C. § 717t-1(a)-(b).

[16] *Compare* FPA § 316A(b), 16 U.S.C. § 825o-1(b), *with* NGA § 22(a)-(b), 15 U.S.C. § 717t-1(a)-(b). There is one point of divergence: unlike the FPA (and the NGPA), the NGA does not expressly require FERC to issue an order when it assesses civil penalties (though it is unclear how FERC could assess penalties without issuing an order).

[17] *Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317 at P 8 (2006).

[18] *FERC v. Powhatan Energy Fund, LLC*, 949 F.3d 891, 898-900 (4th Cir. 2020); *FERC v. Vitol*, 79 F.4th 1059, 1063-66 (9th Cir. 2023).

[19] *Powhatan*, 949 F.3d at 898-899 (emphases added) (quoting 16 U.S.C. § 823b(d)(3)(B)).

[20] *Vitol*, 79 F.4th at 1063 (emphasis added).

[21] Seizing on the FPA’s use of the word “review,” FERC argued for several years that the court option did not require a trial or other typical trial trappings like discovery. According to FERC, if the subject of a show cause order wanted discovery and a trial, then it needed to elect the ALJ option. That, in FERC’s view, gave proper force to the FPA’s language requiring FERC to issue a penalty assessment order after considering specific factors. But all seven federal district courts that have addressed FERC’s position have rejected it, ruling that a FERC civil penalty action proceeds like any other civil action, with discovery, potential dispositive motions, and trial—including a trial by jury, if either party so elects. *FERC v. Powhatan Energy Fund, LLC*, 286 F.Supp.3d 751 (E.D. Va. 2017); *FERC v. Barclays Bank PLC*, 247 F.Supp.3d 1118 (E.D. Cal. 2017); *FERC v. ETRACOM LLC*, U.S. Dist. LEXIS 33430 (E.D. Cal. 2017); *FERC v. Silkman*, 233 F.Supp.3d 201 (D. Me. 2017); *FERC v. City Power Mktg. LLC*, 199 F.Supp.3d 218 (D.D.C. 2016); *FERC v. Maxim Power Corp.*, 196 F. Supp.3d 181 (D. Mass. 2016); *FERC v. Coaltrain Energy, L.P.*, Civil Action No. 2:16-cv-732 (E.D. Oh. May 9, 2018) (magistrate memorandum of first prehearing conference).

[22] *Powhatan*, 949 F.3d at 900.

[23] 18 C.F.R. § 385.213(c)-(d).

[24] *Jarkesy*, 144 S.Ct. at 2131.

[25] *Id.* at 2129.

[26] *Id.*

[27] *Id.* (quoting *Tull v. United States*, 481 U.S. 412, 422 (1987)); *see also id.* (“Applying these principles, we have recognized that ‘civil penal[t]ies are] a type of remedy at common law that could only be enforced in courts of law.’”) (quoting *Tull*, 481 U.S. at 422) (alterations in original).

[28] *Jarkesy*, 144 S.Ct. at 2130 (cleaned up).

[29] Compare *Jarkesy*, 144 S.Ct. at 2130, with *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156 at P 51 (2008) (explaining how Congress has directed FERC to assess civil penalties punitively, in light of the seriousness of the violation, as opposed to making alleged victims whole), and *Policy Statement on Penalty Guidelines*, 130 FERC ¶ 61,220 at PP 18, 43-50 (2010) (discussing the role of culpability and culpability scores under the guidelines).

[30] Compare *Jarkesy*, 144 S.Ct. at 2129, with *Revised Policy Statement*, 123 FERC ¶ 61,156 at P 51), and *Policy Statement on Penalty Guidelines*, 130 FERC ¶ 61,220 at PP 18, 43-50.

[31] Compare *Jarkesy*, 144 S.Ct. at 2130, with *Revised Policy Statement*, 123 FERC ¶ 61,156 at PP 3 (noting the “deterrent effect” of FERC civil penalties), and *Policy Statement on Penalty Guidelines*, 130 FERC ¶ 61,220 at PP 18, 43-50.

[32] 144 S.Ct. 2126.

[33] 186 FERC ¶ 61,017 at P 8. That is over twice the SEC civil penalty amount of \$725,000 per day per violation—an amount *Jarkesy* says is “among the SEC’s most potent enforcement tools.”

[34] *Jarkesy* involved allegations of fraud-based market manipulation in violation of section 10b of the Securities and Exchange Act that “bears a close relationship with common law fraud.” 144 S.Ct. at 2130. FERC has similar authority under the FPA and NGA, which not only prohibit fraud-based market manipulation, but also take the additional step of specifying that the key statutory terms have the same meaning as they do “in section 10b of the Securities Exchange Act of 1934.” FPA § 222, 16 U.S.C. § 824v(a); NGA

§ 4A, 15 U.S.C. § 717c-1. But the constitutional problem with FERC enforcement is broader than this category of cases alleging fraud because it is the punitive nature of civil penalties under FERC's statutes that drives the outcome.

[35] *Jarkesy*, 144 S.Ct. at 2140.

[36] *Id.* One example of a due process violation comes from *Jarkesy* itself. Adjudicating civil penalties in-house requires ethics screens to make sure that the agency litigation staff is kept separate from the agency decisional staff. As Justice Gorsuch noted in his concurrence, while *Jarkesy*'s case was pending at the SEC, agency litigation staff violated an ethics screen by improperly accessing confidential memoranda written by agency advisory staff. *Id.* at 2142. Several years ago, a similar violation of ethics screens occurred at FERC. *GreenHat Energy, LLC*, 178 FERC ¶ 61,002 (2022) (Daly, Comm'r, dissenting).

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