

CLIENT ALERT

# Federal District Court Blocks FERC's Path to Disgorgement and Joint and Several Liability

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## AUTHORS

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In a significant and decisive jurisdictional decision, the United States District Court for the Southern District of Ohio held on November 29, 2021 that it had no statutory authority to review the Federal Energy Regulatory Commission's ("FERC" or "Commission") order imposing joint and several liability and disgorgement of unjust profits against Coaltrain Energy, L.P. and the individual defendants (collectively, the "Defendants").<sup>1</sup> FERC argued that section 309 of the Federal Power Act ("FPA") authorizes it to impose joint and several liability and to require disgorgement. Defendants contended that FERC has no such authority. Side-stepping the question of whether the Commission has authority under Section 309 to issue an order imposing joint and several liability and disgorgement, the court held that *it* lacked authority to review FERC's order assessing those remedies under FPA section 31(d).<sup>2</sup> Because the court's decision turned on its analysis of the FPA, FERC litigants are likely to argue that the decision bars district court review of any remedy other than civil penalties in actions to enforce penalty assessments under FERC's anti-manipulation rule using the procedures in FPA section 31(d).<sup>3</sup>

In this client alert, we first describe the statutory basis for the procedures used by FERC to impose penalties, disgorgement, and joint and several liability. Second, we explain the court's reasoning and decision. Third, we discuss the significant implications of the court's decision.

<sup>1</sup> Opinion and Order, *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732 (S.D. Ohio Nov. 29, 2021) (the "Coaltrain Order").

<sup>2</sup> 16 U.S.C. § 823b(d).

<sup>3</sup> FERC's anti-manipulation rule is found in 18 C.F.R. § 1c.

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### Statutory and Procedural Background

In order to understand the court's decision, it is important to recognize the structure of the statutory provisions under which FERC's assessment order came before the court for review. The FPA authorizes FERC to impose civil penalties for violations of the anti-manipulation provisions of the FPA by using the procedures in FPA section 31(d). Section 31(d) requires FERC to provide notice of the proposed penalty and permit the respondent thirty days to choose one of two pathways to challenge liability. A respondent may elect: (1) to have FERC's allegations adjudicated before an Administrative Law Judge ("ALJ");<sup>4</sup> or (2) to require FERC "promptly" to assess civil penalties and, if the civil penalty is not paid, file a complaint seeking *de novo* review in federal court (the "De Novo Review Option").<sup>5</sup>

To pursue the De Novo Review Option's penalty assessment, FERC chose to use an Order to Show Cause ("OSC") process in which FERC issues the statutorily required notice of proposed penalty and opportunity to elect procedures simultaneously with an OSC.<sup>6</sup> The OSC attaches the allegations of the Office of Enforcement and requires the respondents to answer the allegations. FERC asserts that it considers the allegations, answer, and staff's reply, and then renders a neutral decision in the form of a penalty assessment order.

In *Coaltrain*, FERC issued an Order to Show Cause and Notice of Proposed Penalty on January 6, 2016.<sup>7</sup> Defendants elected the De Novo Review Option, which led to FERC's Order Assessing Civil Penalties ("Penalty Assessment") on May 27, 2016.<sup>8</sup> The Penalty Assessment imposed civil penalties of \$26,000,000 against Coaltrain (jointly and severally with defendants Peter Jones and Shawn Sheehan); \$5,000,000 against P. Jones; \$5,000,000 against Sheehan; \$1,000,000 against Robert Jones; \$500,000 against Jeff Miller; and \$500,000 against Jack Wells.<sup>9</sup> In addition, the Commission directed Coaltrain, P. Jones, and Sheehan to disgorge, jointly and severally, unjust profits, plus applicable interest, pursuant to section 309 of the FPA, in the amount of \$4,121,894.<sup>10</sup> The Defendants did not pay the penalties or

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<sup>4</sup> 16 U.S.C. § 823b(d)(2).

<sup>5</sup> See 16 U.S.C. § 823b(d)(3)(B).

<sup>6</sup> The OSC process is not mentioned in the statute, and some, including us, have argued is not required by it. See, e.g., Defendants' Memorandum of Law at 17, *FERC v. Powhatan Energy Fund, LLC*, No. 3:15-cv-00452-MHL (E.D. Va. Dec. 31, 2015) (in which defendants argued that "the language creating judicial procedures under section 31(d)(3) never refers to . . . an 'adversarial Order to Show Cause process.'"). Courts generally have agreed that the respondents are entitled to a full trial *de novo* under the Federal Rules of Civil Procedure, as opposed to the truncated federal action advocated by FERC.

<sup>7</sup> *Coaltrain Energy, L.P.*, 154 FERC ¶ 61,002, at P 1 (2016).

<sup>8</sup> Petition for an Order Affirming FERC's May 27, 2016 Order Assessing Civil Penalties at PP 50, 52, *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732 (S.D. Ohio July 27, 2016) (the "Complaint").

<sup>9</sup> *Coaltrain Energy, L.P.*, 155 FERC ¶ 61,204, at P 1 (2016).

<sup>10</sup> *Id.*

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disgorgement, triggering FERC's July 27, 2016 Complaint petitioning the court to review, affirm, and enforce its Penalty Assessment.<sup>11</sup>

At a May 26, 2021 status conference in the federal court action, Defendants requested permission to brief whether they “may be held jointly and severally liable and what remedies Plaintiff may properly pursue.”<sup>12</sup> The court allowed the briefing, and the parties focused their briefs on whether FERC had authority to order disgorgement or joint and several liability. Defendants argued that FERC did not have such authority for two main reasons: (1) Congress did not explicitly grant FERC authority to order disgorgement or joint and several liability; and (2) FERC's authority to order these remedies under a “catch-all” provision in section 309 of the FPA conflicts with other more specific provisions of the FPA.<sup>13</sup> FERC countered that a long line of cases established its broad FPA section 309 authority to order disgorgement and joint and several liability.<sup>14</sup>

### The Court's Decision

The court held that, although FERC supported with “considerable caselaw and compelling arguments” its contention that the Commission has authority to impose disgorgement and joint and several liability, the *court* lacked authority to review FERC's order of those remedies.<sup>15</sup> The court reasoned that FERC brought the case—including the civil penalties, disgorgement and joint and several liability—based upon the FPA's section 31(d) procedures. Those procedures address only civil penalties, not disgorgement or joint and several liability.

The court explained that FPA section 309, FERC's broad “necessary or appropriate” authority pursuant to which the agency ordered disgorgement and joint and several liability, provides for federal court review of orders arising thereunder in a United States court of appeals, not a district court. See 16 U.S.C. § 825f. The court also emphasized that disgorgement and joint and several liability are not civil penalties. Accordingly, the court held that, “to the extent that FERC attempts to use its powers under § 309 to impose disgorgement or joint and several liability against Defendants, this Court lacks jurisdiction to review such an award.”<sup>16</sup> The court also rejected FERC's argument that, even in absence of express statutory authority, the court had independent authority to impose the remedies. It explained that “Congress

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<sup>11</sup> Complaint at 1.

<sup>12</sup> Order, *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732 (S.D. Ohio May 26, 2021).

<sup>13</sup> Brief for Defendants at 6, 10-11, 17-18, *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732 (S.D. Ohio July 2, 2021).

<sup>14</sup> Brief for Plaintiff at 5, *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732 (S.D. Ohio July 30, 2021).

<sup>15</sup> *Coaltrain* Order at 2.

<sup>16</sup> *Id.*

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limited the district courts' power when reviewing FERC orders," and "the Court will not extend its powers to craft remedies beyond the borders Congress drew for these types of cases."<sup>17</sup>

### Implications of the Decision

*The Court's Statutory Interpretation Appears to Apply Broadly.* If correct, the court's decision would apply to all civil penalty actions that use the FPA's section 31(d) procedures, including actions to enforce FERC's anti-manipulation rule.

*The Court's Statutory Analysis Leaves Big Questions Unanswered.* The court explained that if FERC wishes to impose disgorgement or joint and several liability, "it must follow the procedures outlined in 16 U.S.C. § 825."<sup>18</sup> However, the process that FERC could use to impose both civil penalties, and disgorgement and joint and several liability in the same proceeding is not clear. FERC's OSC process under FPA section 31(d) does not contemplate a separate administrative proceeding before an ALJ to determine disgorgement or joint and several liability.

*Pending Cases May Add Clarity to FERC's Authority.* As we summarized on November 18, 2021, the Commission imposed civil penalties, disgorgement and joint and several liability in the GreenHat Energy LLC proceeding.<sup>19</sup> The case has not yet proceeded to federal court. In addition, there are two cases in which FERC seeks to impose disgorgement currently pending in federal district court: *FERC v. Powhatan Energy Fund LLC*, No. 3:15-cv-00452, in the U.S. District Court for the Eastern District of Virginia, and *FERC v. Vitol Inc.*, No. 2:20-CV-00040-KJM-AC, in the U.S. District Court for the Eastern District of California. In *Powhatan*, FERC also sought to impose joint and several liability.<sup>20</sup> If the courts in these cases agree with *Coaltrain*, FERC will face more pressure to revise its processes for imposing remedies beyond civil penalties in actions subject to the procedures in FPA section 31(d).

### Conclusion

The court's decision has the potential to significantly impact FERC's approach to the imposition of remedies for market manipulation and other violations of the FPA. For now, however, FERC may argue that the court was wrong and stick to its interpretation of the FPA. That is how FERC proceeded in the face of decisions that did not go its way interpreting the

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<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> See Norman C. Bay, *et al.*, *FERC Imposes Substantial Penalties and Disgorgement in GreenHat Case Over Forceful Dissent of Commissioner Danly* (Nov. 18, 2021), available [here](#).

<sup>20</sup> *Powhatan Energy Fund, LLC, et al.*, 151 FERC ¶ 61,179, at P 165 (2015).

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nature of *de novo* review in federal court.<sup>21</sup> If enough courts agree with *Coaltrain*, FERC may need to alter its processes or seek a legislative change.

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<sup>21</sup> See, e.g., *FERC v. Powhatan Energy Fund, LLC*, 286 F. Supp. 3d 751, 769-70 (E.D. Va. Dec. 28, 2017) (rejecting FERC's argument that the OSC process afforded respondents "sufficient opportunity to present their case," and holding that respondents were entitled to a *de novo* trial); *FERC v. Silkman*, 233 F. Supp. 3d 201, 226 (D. Me. Jan. 26, 2017) (holding that "the Court shares the Respondents' concerns that the Commission's procedures [prior to the district court action] deprived the Respondents of an adequate opportunity to present their case and defend against Enforcement's accusations," and thus, "it is appropriate . . . to expand the scope of [the court's] *de novo* review and treat this case as an ordinary civil action governed by the Federal Rules."); *FERC v. City Power Marketing, LLC*, 199 F. Supp. 3d 218, 231-32 (D.D.C. Aug. 10, 2016) (rejecting FERC's argument that the court should not engage in plenary adjudication, and holding that "the Court will treat this case like a normal civil action governed by the Federal Rules.").