

Supreme Court: Hears Oral Argument on Whether the SEC May Seek and Obtain Disgorgement in Civil Enforcement Proceedings

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On March 3, 2020, the Supreme Court heard oral arguments in *Liu v. SEC*, No. 18-1501. At issue is whether existing legislation authorizes the SEC to seek disgorgement of profits as “equitable relief” in district court proceedings to enforce the Securities Act of 1933 and the Securities Exchange Act of 1934.

Background

In the case before the Court, defendants-petitioners (“Petitioners”) raised approximately \$27 million for a project, but misappropriated the bulk of the investment. The district court imposed penalties of \$8 million (the amount of the salaries defendants received) and ordered disgorgement of the remaining \$19 million defendants took from investors. The district court declined to offset the disgorgement amount by Petitioners’ legitimate business expenses (approximately \$4.5 million). The Ninth Circuit affirmed the district court’s decision.

The SEC often seeks disgorgement in cases where it believes defendants have defrauded or deliberately deceived investors. In 2019, the SEC obtained \$3.2 billion in disgorgement, compared with \$1.1 billion in civil penalties; the SEC returned 37% of disgorged profits to harmed investors, with the remainder of disgorged funds dispensed to the U.S. Treasury.

Congress has authorized the SEC to seek disgorgement in its own administrative proceedings, *see* 15 U.S.C. § 78u-2(e), but has not expressly authorized disgorgement when the SEC seeks such relief in federal court. Instead, Congress has authorized the SEC to seek a range of remedies in district court proceedings, including “any equitable relief that may be appropriate or necessary for the benefit of investors.” 15 U.S.C. § 78(u)(d)(5). The Court recently held in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), that disgorgement of profits is a penalty, and not an equitable remedy, for purposes of the statute of limitations set forth in 28 U.S.C. § 2462.^[1] The unanimous *Kokesh* Court did not reach the question of whether the SEC can seek disgorgement in district court proceedings.

Several Justices Express Concern Regarding the Punitive Nature of the Disgorgement Sought by the SEC in the Case Before It

During oral argument, the Justices focused on the seemingly punitive nature of the disgorgement the SEC sought in the case before it. The

Justices asked whether disgorged funds should be returned to investors and appeared concerned that here, the SEC sought to disgorge all of the investments Petitioners raised, not just their profits.

Justice Alito asked Petitioners’ counsel if the remedy would be equitable if it were limited to net profits instead of the entire amount Petitioners took in from investors. Petitioners’ counsel responded that a similar remedy in equity would be based on profits, but that such a remedy would normally only be available for breaches of fiduciary duty, which the SEC did not plead or prove in this case. When Justice Kavanaugh followed up on the relevance of the disgorgement’s calculation as revenues or profits, Petitioners’ counsel noted that there is not even agreement among the circuit courts as to what disgorgement is and how it should be calculated and urged that Congress, not the Court, should be responsible for crafting the scope of disgorgement and determining how it should be calculated.

Justice Kavanaugh asked if the analysis would be different if disgorged funds were dispersed to investors (instead of the Treasury). Petitioners’ counsel acknowledged that this would address one of the main inconsistencies between the disgorgement obtained by the SEC and traditional equitable remedies. Nonetheless, Petitioner’s counsel insisted that the disgorgement sought by the SEC “was clearly a penalty and clearly inconsistent with *Kokesh*.” Justice Ginsburg observed that the context of *Kokesh*, which concerned the statute of limitations set forth in 28 U.S.C. § 2462, was vastly different from the equitable remedy question at issue in *Liu*. She noted the equitable principle that wrongdoers should not profit from their wrongs. Counsel for the SEC downplayed the significance of *Kokesh* and instead pointed the Court to *Kansas v. Nebraska*, 135 S. Ct. 1042 (2015), a case where disgorgement was ordered as an equitable remedy.

Justices Sotomayor and Gorsuch asked how the SEC decides whether to return money to investors or distribute it to the Treasury. Counsel for the SEC explained that while the SEC attempts to return disgorged funds to investors, there are some cases, such as those arising under the Foreign Corrupt Practices Act, in which there may not be an individual victim who should receive the disgorgement proceeds. Justice Kavanaugh questioned whether the Supreme Court should announce a rule on how disgorgement is calculated or leave it to district courts to decide.

Justice Ginsburg probed the SEC’s position that administrative proceedings (in which the SEC is statutorily authorized to seek disgorgement) are an inadequate substitute for district court proceedings. She noted that the SEC could take an administrative order to a district court for enforcement if needed. Counsel for the SEC responded that the SEC often proceeds in district court when it has doubts about a defendant’s compliance, allowing for a more streamlined enforcement action.

The Supreme Court will rule on *Liu v. SEC* later this Term.

[1] Please [click here](#) to read our discussion of the Supreme Court’s decision in *Kokesh*.

Authors and
Contacts

Lynn Neuner
Partner
lneuner@stblaw.com
[+1-212-455-2696](tel:+12124552696)

George Wang
Partner
gwang@stblaw.com

Cheryl Scarboro
Of Counsel
cscarboro@stblaw.com
[+1-202-636-5529](tel:+12026365529)

